Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593

REPLY COMMENTS OF AT&T INC.

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Pursuant to the Commission's *Notice*,[1] AT&T Inc. ("AT&T") respectfully submits these Reply Comments.

INTRODUCTION AND SUMMARY

The Commission's broadband workshops have made it abundantly clear that the nation will need massive new investment in broadband networks over the next several years. As data traffic continues to increase exponentially, especially over wireless networks,[2] workshop participants unanimously affirmed that service providers will require vastly greater backhaul

[1] Public Notice, *Parties Asked To Comment On Analytical Framework Necessary To Resolve Issues In The Special Access NPRM*, WC Docket No. 05-25, RM-10593, DA 09-2388 (rel. Nov. 5, 2009) ("*Notice*").

[2] AT&T, for example, has experienced 6,732% growth in wireless data traffic over 13 quarters from 3Q06 to 3Q09. John Donovan (Chief Technology Officer, AT&T Inc.), *Apps for All – Building an Application-Centric Network*, 2010 AT&T Developer Summit, at 3 (2010), *available at* http://www.att.com/Common/about_us/files/pdf/DevSummit2010Donovan.pdf. T-Mobile recently told the Commission that its G1 customers use 50 times the data of the average T-Mobile customer, and that wireless laptops will use 450 times the amount of data. *See* Letter from Kathleen O'Brien Ham (T-Mobile) to Marlene H. Dortch (FCC), GN Docket No. 09-51, Attachment at 9-10 (August 6, 2009).

transmission capacity and speeds. As one participant bluntly put it, "T1s are out . . . it's either going to be fiber or its going to be microwave."[3] A broad cross-section of providers, including LECs, cable companies and wireless providers, are poised to meet this demand with high-capacity Ethernet, fiber, and wireless microwave transmission facilities – even in more remote and rural areas where such investment was previously less prevalent. In this environment, it should be obvious that all of the Commission's policy initiatives should be working in concert to maximize providers' incentives to continue these multi-billion dollar investments.

Yet the industry remains mired in a seemingly endless debate about the rates and terms for the price cap LECs' legacy copper, TDM, DSn-level facilities which are being rapidly replaced by this wave of broadband investment. The debate continues even though, for almost a decade, re-regulation proponents have based their claims on nothing more than rhetoric, unverifiable anecdotes, the facile use of ARMIS-derived returns that are obviously inaccurate, and spurious apples-to-oranges comparisons, the validity of which have been refuted repeatedly.

At long last, the Commission's new *Notice* has finally made clear that re-regulation proponents will not obtain the multi-billion dollar price breaks they are seeking without producing actual *data* to back up their claims.[4] Accordingly, these commenters now pay lip service to the need for more detailed data from competitors. Unfortunately, however, their actual proposals are not designed to create a record for reasoned fact-based decision-making: instead

[3] *See, e.g.*, National Broadband Plan Workshop; Deployment – Wired Transcript (Aug. 12, 2009), at 45 (David Armentrout, FiberNet).

[4] *See, e.g.*, Comments of the NoChokePoints Coal., WC Docket No. 05-25, RM-10592, at 17 (Jan. 19, 2010) ("NoChokePoints") (acknowledging the Commission should collect "from non-ILEC facilities-based competitors" specific information about their collocations, their interoffice transport and channel termination facilities, and their own internal analyses of the circumstances in which they build new connections, to permit the Commission to determine "the extent to which the presence of collocated facilities in an MSA correlates with the presence of competition for channel terminations and interoffice transport").

they seek to build enough smoke machines and mirrors into the "analytical framework" to rig the outcome in their favor.

For example, these commenters urge the Commission to ignore entire categories of important special access competition, including cable competitors, wireless microwave competitors, and even competition from existing wireline networks. They try to coax the Commission down rabbit holes of irrelevant analysis, such as route-by-route, building-by-building or even floor-by-floor inquiries that are neither necessary nor remotely administrable or analyses of accounting profits that have no theoretical validity in this context. They argue that the Commission should keep the competitive data it collects secret from all commenters – even from the price cap LECs that are the target of these commenters' accusations, and even from outside attorneys and experts who have signed a stringent protective order. And these commenters cannot even wait for the Commission to conduct the results-driven analyses they have requested, as many of them demand that the Commission immediately impose "interim" rate freezes or reductions that simply *assume* – contrary to the overwhelming weight of record evidence – that the price cap LECs' current DS1 and DS3 rates are, without exception, unjust and unreasonable. In other words, the re-regulation proponents' approach is: shoot first, ask the wrong questions later, and blindfold the prisoners.

Although these proposals are patently arbitrary and unlawful, it is not surprising that these commenters would do everything possible to redirect this proceeding away from an honest and transparent examination of the relevant competitive data, because the last thing they want is a rigorous, data-driven inquiry into whether the current pricing flexibility rules are working as intended. Even on the record as it stands – before a full accounting from special access competitors on the scope of their networks – it is clear that the pricing flexibility rules are

serving their purpose. Over the decade that these rules have been in place, the prices that special access customers actually pay have decreased dramatically, output has risen sharply, both incumbents and their competitors have invested billions in new facilities, innovation has increased, and customers have benefitted from negotiated contract tariffs with rates and terms tailored to their individual needs.

Given these unrefuted facts, the course of action that would best promote the public interest would be to end this proceeding: artificially reducing the rates of legacy DSn services would only prolong dependence on those facilities and slow down investments in next-generation broadband networks. Indeed, both the Justice Department and the NTIA have emphasized this very point: additional "price regulation is likely to stifle investment in broadband infrastructure or to discourage broadband service innovation."[5]

If the Commission nevertheless moves forward with this proceeding, it must hold re-regulation proponents' feet to the fire. They have had almost a decade to provide data that would substantiate their claim that the special access policies adopted by the Clinton Administration must be repealed, yet they have adamantly refused to do so, even as the ILECs produced reams of data showing these claims to be without merit. There is no basis for perpetuating this proceeding unless reregulation proponents produce data that would enable the Commission to conduct a fact-driven analysis that accounts for all of the relevant competitors and competition.

The remainder of the comments are organized as follows. In Section I, we show that the re-regulation proponents' attempts to obtain "interim" rate reductions or freezes, before the Commission has even undertaken its inquiry here, would be patently unlawful. Any such interim

[5] Letter from Lawrence E. Strickling (National Telecommunications and Information Administration) to FCC Chairman Julius Genachowski, National Broadband Plan, GN Doc. No. 09-51, at 6 (Jan. 4, 2010) ("NTIA Letter"); *Ex Parte Submission of DOJ*, GN Docket No. 09-51, at 28 (Jan. 4, 2010) ("DOJ Broadband Plan Ex Parte").

relief would put the cart before the horse in direct violation of Section 205 of the Communications Act. It would also be patently arbitrary to accept the reregulation proponents' requests to ground such relief in the same ARMIS-derived returns and apples-to-oranges rate comparisons that have been refuted repeatedly (and in some cases specifically rejected by the Commission).

In Section II, we demonstrate that the re-regulation proponents' analytical frameworks for assessing the pricing flexibility triggers would be both unlawful and unworkable. Their proposed frameworks would ignore completely the intermodal and other competition that has rendered the triggers under-inclusive, and they try to import far more complex frameworks from other contexts that are not relevant to pricing flexibility (with the hope, perhaps, of clogging up the Commission's inquiry while they enjoy "interim" relief). In a further effort to frustrate a meaningful inquiry, many of these commenters urge the Commission to violate the Administrative Procedure Act by keeping the data on which it relies secret from all commenters.

In Section III, we discuss the re-regulation proponents' equally inappropriate approaches to assessing the price caps, which depend once again on ARMIS-derived returns that have no validity and their litany of apples-to-oranges rate comparisons that have been refuted and rejected. In addition, the suggestion of some commenters that the Commission should re-adopt the X-Factor it used in the mid-1990s, merely because it was the last one judicially upheld fifteen years ago, would also be arbitrary. And given intervening marketplace developments, "[t]here is no reason, based on the available evidence, to believe that the 5.3 percent X-Factor adopted in 1995 is a better approximation of expected forward looking productivity gains today than the

current X-Factor, or that changing the X-Factor from the status quo would improve matters in any way."[6]

In Section IV, we address the regulation proponents' various attacks on the price cap LECs' discount plans. As detailed below, the types of terms and conditions about which these commenters complain about are commonplace and benefit consumers and enhance economic efficiency in a variety of ways. Thus, as Dr. Carlton explains, there is no basis for questioning such discounting practices absent a showing of the rare case in which exclusion or predation is successful and leads to higher prices. And here, the record evidence proves the contrary: there has been widespread entry and expansion by alternative facilities-based providers. In Section V, we refute the re-regulation proponents' suggestion that the Commission should regulate the Ethernet services of price cap LECs, which even they admit are not remotely dominant providers in the highly fragmented and rapidly growing Ethernet industry. Finally, in Section VI, we show that Global Crossing's suggestion that the Commission should institute a system of "baseball-style" arbitration for special access services would be unlawful.

ARGUMENT

I. THE "INTERIM" RELIEF PROPOSALS ARE UNLAWFUL.

If the Commission intends to continue this proceeding, the way forward is now clear. The Commission must adopt analytical frameworks that focus on the real-world competitive constraints facing price cap LECs today, and it must obtain the data necessary to implement these frameworks in a meaningful fashion. To that end, it must obtain data about all relevant competitors, their networks, and their capabilities. If the Commission follows this blueprint, it

[6] Carlton-Shampine-Sider Reply Decl. ¶ 73, attached hereto as Exhibit A.

can determine whether the current collocation-based triggers predict with reasonable accuracy areas in which incumbent LEC prices are constrained by actual or potential competition.

However, many proponents of new regulation want the Commission to shoot all of the prisoners before it even conducts the trial. They propose radical forms of "interim" relief that would grant them all of the permanent relief they seek, solely on the basis of unsupported assertions about the lack of competition and meaningless apples-to-oranges rate comparisons, before the Commission has even collected, much less analyzed, the relevant data. For example, Level 3 argues that the Commission should adopt a "true freeze" on all existing special access rates.[7] Sprint and Ad Hoc propose even more extreme forms of interim relief, urging the Commission to repeal Phase II flexibility completely and to re-impose price caps. Others argue that the Commission should refuse to consider any new pricing flexibility applications, effectively denying applications that comply with the rules. Sprint proposes an "interim" X-Factor of 5.3 percent.[8]

Only a minority of commenters support these proposals, and for good reason – each and every one of them would be unlawful. For one thing, each would require the Commission to effectively prescribe new interim rates before it even begins its examination of the marketplace, in flat violation of Section 205 of the Act. Once carrier-initiated tariffs take effect, Section 205 provides that the Commission may order a carrier to change the rates or terms of its offer only

[7] *See* Comments of Level 3 Communications, LLC, WC Docket No. 05-25, RM-10593, at 22-23 (Jan. 19, 2010) ("Level 3"); Comments of Paetec Holdings Inc. et al., WC Docket No. 05-25, RM-10593, at 85 (Jan. 19, 2010) ("Paetec") ("the Commission should 'freeze' or 'cap' ILEC special access rates at the current levels on an interim basis").

[8] *E.g.*, Comments of Sprint Nextel Corp, WC Docket No. 05-25, RM-10593, at 46 (Jan. 19, 2010) ("Sprint") ("interim relief should include the elimination of Phase II pricing flexibility pending the comprehensive reform" and should adopt "an interim X-Factor of 5.3 percent"); Comments of Ad Hoc Telecomms. Users Comm., WC Docket No. 05-25, RM-10593, at 7 (Jan. 19, 2010) ("Ad Hoc"); Paetec at 84-88.

after it has conducted a hearing and (1) made definitive findings that the carrier's existing charge or practice "is or will be in violation of any provisions of this Act" and (2) determined "what will be the just and reasonable" charge or practice "to be thereafter followed." 47 U.S.C. § 205.[9] As the courts have repeatedly held, and as the Commission itself has repeatedly recognized, these statutory requirements apply to all prescriptions, whether they are permanent or "interim."[10] Thus, if the Commission presently lacks an adequate record to make these predicate findings – and the entire premise of the current Notice is that the Commission does not even have an "analytical framework" to use in determining whether the ILECs' current rates are just and reasonable – it must "leave the matter of prescription for resolution on an adequate record after further proceedings."[11] Indeed, that is why the Commission has already rejected similar arguments in this very proceeding.[12]

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[9] *AT&T* v. *FCC*, 487 F.2d 865, 872-80 (2d Cir. 1973) (a "full opportunity for hearing" and express Commission findings that the carrier-initiated rate is unjust and unreasonable and the prescribed rate is just and reasonable "are essential to any exercise by the Commission of its authority" to prescribe rates); *Southwestern Bell Corp.* v. *FCC*, 43 F.3d 1515, 1520 (D.C. Cir. 1995) (the "Commission is not free to circumvent or ignore th[e] balance [created by Congress in §§ 203-205]. Nor may the Commission rewrite this statutory scheme on the basis of its own conception of the equities of a particular situation").

[10] *See AT&T* v. *FCC*, 449 F.2d 439, 451 (2d Cir. 1971); *AT&T Revisions to Tariff F.C.C. No. 259, Wide Area Telecomms. Serv.* (*WATS)*, 86 F.C.C. 2d 820, ¶ 88 (1981).

[11] *See AT&T*, 449 F.2d at 451 (striking down interim prescription; since record was insufficient, "§ 205(a) required the Commission to leave the matter of prescription for resolution on an adequate record"); *AT&T Revisions to Tariff F.C.C. No. 259, Wide Area Telecomms. Serv.* (*WATS)*, 86 F.C.C. 2d ¶ 88 (rejecting interim phase-in" proposal, because "we now have no record on which to base such a prescription. Section 205 of the Act, 47 U.S.C. § 205, permits the Commission to prescribe just, fair, and reasonable charges, regulations or practices only after hearing. Since we have not yet investigated NTS costs, we are not in a position to determine whether such proposals are reasonable").

[12] *See, e.g.*, Order and Notice of Proposed Rulemaking, *Special Access Rates For Price Cap Local Exchange Carriers; AT&T Petition For Regulation Of Incumbent Local Exchange Carrier Rates For Interstate Special Access Services*, 20 FCC Rcd. 1994, ¶ 130 (2005) ("*Special Access NPRM*") ("the record does not support a finding that every special access rate established pursuant to a grant of Phase II pricing flexibility violates section 201 of the Communications

These proposals would be all the more unlawful given that the Commission would in most cases be surgically rewriting customized *contract tariffs* that are the product of voluntary agreement. Under the "true freeze" proposal, for example, the Commission would require price cap LECs to file amended contract tariffs to give these commenters new contractual provisions that override and extend the term period expressly defined by the tariffs. Similarly, if the Commission were to repeal Phase II relief on an "interim" basis, the Commission would be abrogating contractually negotiated discount arrangements and replacing those arrangements with new tariffed arrangements. In both instances, the Commission would prescribe new contractual terms without even examining whether the existing terms are just and reasonable. That would be a clear violation of § 205.[13]

And even if that were not the case, it is well settled under the *Sierra-Mobile* doctrine that the Commission may re-write a contract tariff "only if there exists a compelling public interest in doing so, or convincing evidence of unfairness in the contract formation process,"[14] and these

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Act" and "we find the record inadequate for prescribing new special access rates pursuant to section 205 of the Communications Act"). Indeed, the Commission explained to the D.C. Circuit, in defending its decision not to grant these same proposals for interim relief at an earlier stage in this proceeding, that "in order to justify the interim prescription relief sought by petitioners, the record would have to support the conclusion that *every* special access rate in *every* MSA in which Phase II relief has been granted violates Section 201." *In re AT&T Corp., et al.*, No. 03-1397, Brief of Respondent FCC at 23 (emphasis in original).

[13] *See, e.g., AT&T*, 487 F.2d at 874; *see also AT&T, Charges for Private Line Servs. Revisions of Tariff FCC Nos. 260, 264, 266 (Series 2000/3000 and 5000)*, 85 F.C.C.2d 549, ¶ 20-21 & n.20 (1981) ("[t]he Commission can only prescribe rates affirmatively found just and reasonable. . . . Ordering a 'rollback' to rates which were no longer in effect would simply amount to a prescription in another guise . . . [which would be inappropriate here because] we cannot find any specific rate level to be just and reasonable on the basis of the present record and existing cost allocation procedures").

[14] *Ryder Commc'ns* v. *AT&T Corp.*, 18 FCC Rcd. 13603, ¶ 24 (2003) ("This preserves the integrity of contracts, which is vital to the proper functioning of any commercial enterprise, including the communications market"); *see also Fed. Power Comm'n* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956); *United Gas Pipeline Co.* v. *Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *IDB Mobile Commc'ns, Inc.* v. *COMSAT Corp.*, 16 FCC Rcd. 11474 (2001).

commenters have not even attempted to satisfy that standard. As the Commission has held elsewhere, "[t]here is simply no justification for allowing [a party] . . . to negotiate for concessions on price, to sign a contract containing customized provisions that are the product of voluntary agreement, and then to run to the Commission to have the Commission reform a provision of the contract that was an integral part of the *quid pro quo* bargain but which subsequently produces hardship to the customer."[15]

These proposals would also be unworkable. Contract tariffs are individually negotiated between a carrier and its customer, and they are bilateral agreements that confer obligations (as well as benefits) on customers. Under these commenters' proposals, price cap LECs would be required to amend their contract tariffs to extend the entirety of these deals – including the customer's obligations under them – for much longer periods than agreed to by the customers.[16] But it is not at all clear how such extensions would work. Many contract tariffs establish benefits that are contingent in any given year on specified customer obligations, and those obligations frequently vary from year to year under the terms of the contract. There would be no obvious way of determining how such obligations should be extrapolated to years beyond the expiration of the agreement. The Commission would, in effect, be prescribing both the *quid* and the *quo* for years beyond the expiration of the terms, which simply highlights the absurdity of using "true freezes" or other rate determinations to supplant contractual negotiations.

But even if these proposals were not precluded by Section 205, there is no record basis to support interim relief here. It is well-settled that an agency can justify "interim" relief only where it will preserve the *status quo* and the agency has "substantial evidence" to conclude that

[15] *Ryder Commc'ns*, 18 FCC Rcd. 13603, at ¶ 28.

[16] *See, e.g.*, Level 3 at 22 ("customers who wish to continue purchasing services at frozen rates would be required comply with all tariffed conditions (such as volume purchase commitments) applicable to those rates"); Paetec at 87 (same).

there is in fact a problem that requires permanent reform.[17] Most of the radical forms of "interim" relief proposed here clearly would *not* preserve the *status quo* (for example, the "true freeze" would supplant the *status quo* (marketplace negotiations) with Commission-prescribed contracts). But putting that aside, there is no "substantial evidence" that there is any problem to be solved.

Indeed, the evidence in the record shows unequivocally that special access prices have consistently declined over the last decade, and output and innovation have increased dramatically.[18] New competitors continue to enter the market and invest billions of dollars to deploy alternative facilities.[19] Customers routinely take advantage of the pricing flexibility rules to negotiate customized arrangements tailored to their individual needs. It is undisputed that facilities-based competition is already prevalent even in MSAs governed by price caps and that intermodal competitors are rapidly increasing their investments in alternative facilities, even outside of downtown areas where special access demand was historically concentrated, and that

[17] *See, e.g.*, *MCI Telecomms. Corp.* v. *FCC*, 750 F.2d 135, 141 (D.C. Cir. 1984) (court will defer to agency on interim relief "when it acts to maintain the status quo" and where it had "substantial evidence" of the need for interim relief to "avoid 'compounding present difficulties'"); *CompTel* v. *FCC*, 309 F.3d 8, 14-15 (D.C. Cir. 2002) ("[a]voidance of market disruption pending broader reform is, of course, a standard and accepted justification for a temporary rule"); *Rural Cellular Ass'n* v. *FCC*, 588 F.3d 1095, 1105-06 (D.C. Cir. 2009) (interim relief must be supported by "substantial evidence" and deference appropriate when interim relief is for "avoidance of market disruptions").

[18] *See, e.g.*, Comments of AT&T Inc., WC Docket No. 05-25, RM-10593, at 20, 25 (Jan. 19, 2010) ("AT&T"); Comments of Verizon & Verizon Wireless, WC Docket No. 05-25, RM-10593, at 5-8 (Jan. 19, 2010) ("Verizon"); Comments of Qwest Commc'ns Inc., WC Docket No. 05-25, RM-10593, at 9-10 (Jan. 19, 2010) ("Qwest"); AT&T 2005 Reply Comments, FCC WC Docket No. 05-25, Casto Reply Declaration, ¶ 14 (filed July 29, 2005); AT&T Comments, WC Docket No. 05-25, RM-10593, Casto Decl., ¶ 57 (filed August 8, 2007) ("Casto 2007 Decl.").

[19] *See, e.g.*, AT&T at 28-39; Qwest at 10-17; Verizon at 18-27.

the current pricing flexibility triggers do not even capture this competition. On the record as it stands now, interim relief would be patently arbitrary.[20]

The commenters asking for interim relief ignore all of this evidence, and instead ask the Commission simply to *assume* that once it collects more data the evidence will reverse itself and compel drastic industry-wide relief. What do they offer in support of this assumption? The same unsupported and quite obviously counterfactual and meaningless assertions they have been making for years. Many of these commenters reflexively cite ARMIS returns as "proof" that current rates are not constrained by competition, but the Commission has already specifically rejected that claim in this proceeding.[21] Ad Hoc is the only commenter that even attempts a substantive defense of ARMIS is this latest round of comments, and as shown below in Section III, Ad Hoc's claims are meritless.

They also falsely claim special access prices have gone up. Tellingly, none of the regulation proponents have submitted any evidence here disputing the ILECs' showing that the prices they actually pay have been decreasing. They simply repeat by rote the same baseless claims they have been making for years – namely, that the 2006 GAO Report and the 2009 NRRI Report found such prices to be increasing.[22] In reality, both of those reports expressly found that the prices paid for RBOC DSn prices have uniformly *declined* in Phase II areas. The GAO Report found that in Phase II areas, its "analysis of average revenue data for channel

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[20] *See, e.g., Ill. Pub. Telecomms. Ass'n* v. *FCC*, 117 F.3d 555, 565 (D.C. Cir. 1997) (interim payphone rates unlawful because not supported by the record evidence).

[21] *See Special Access NPRM* ¶ 129 (rejecting request for interim special access rate reductions premised on ARMIS rates of return, expressly "question[ing the] central reliance on accounting rate of return data to draw conclusions about market power" because "[h]igh or increasing rates of return calculated using regulatory cost assignments for special access services do not in themselves indicate the exercise of monopoly power").

[22] *See, e.g.*, NoChokePoints at 20; Sprint at 34 & Mitchell Decl. at 110.

terminations and transport for both DS-1 and DS-3 shows that, in general, average revenue has declined in nominal dollars."[23] Similarly, the NRRI Report states that special access *purchasers* reported that the rates they actually pay declined from 2006 to 2007 and that "[o]ne possible explanation is that competition is driving prices down for customers purchasing at discounted prices."[24]

The only other "evidence" offered by re-regulation proponents are meaningless apples-to-oranges comparisons of special access prices – typically "rack" rates that do not even reflect what customers actually pay.[25] For example, they complain that special access rates are higher than residential DSL services, state-determined UNE rates, CLEC rates, NECA rates, and even certain rates in the United Kingdom. AT&T and others have thoroughly refuted these bogus comparisons time and again in this proceeding, and the Commission itself has expressly rejected

[23] Gov't Accountability Office, *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, GAO-07-80, at 32 (Nov. 2006) ("GAO Report"); *see also* Peter Bluhm With Dr. Robert Loube, National Regulatory Research Institute, Competitive Issues In Special Access Markets, Revised Edition, at 58 (First Issued Jan. 21, 2009) ("NRRI Report") ("The GAO found that both list prices and average revenues for special access declined from 2001 to 2006").

[24] NRRI Report at 59 & Table 7. The only commenter that addresses the price cap LECs' ARPU evidence at all is Sprint's witness, Dr. Mitchell, but he misunderstands the data. Although he claims that the ARPU statistics reflect a composite of "rates subject to price caps and rates subject to pricing flexibility," Mitchell Decl. ¶ 103, in fact the ARPU data showing significant price declines since 2001 has been provided *separately* for pricing flexibility areas and separately for DS1 and DS3 services. *See, e.g.*, Casto 2007 Decl. ¶ 31. Dr. Mitchell's other criticism that the ARPU analyses include "revenues averaged over different mixtures of volumes, contract durations (and other terms) and rate elements subject to pricing flexibility." *Id.* But examining *average* revenue per unit is a standard and meaningful measure of pricing trends; the only alternative would be to examine precisely what each customer pays for each circuit and then measure pricing trends for each of those hundreds of thousands of circuits which would obviously be infeasible.

[25] Carlton-Shampine-Sider Reply Decl., ¶ 15.

most of them.[26] Accordingly, rather than fully repeat those discussions here, we address them in Appendix A to this Reply.

Not surprisingly, the re-regulation proponents do not cite any authority for the proposition that the Commission could base interim relief on such flimsy evidence, and two cases that Level 3 and Paetec do cite in support of their "true freeze" proposal are inapposite. One such decision, ironically enough, is the Commission's decision to freeze the separations factors on the grounds that they were no longer being used for any ratemaking purpose. This case is of no help to Level 3 because the freeze did not "disrupt" or even change any marketplace realities. Instead, the freeze was enacted to spare ILECs the time and expense of updating and maintaining cost allocation manuals that were deemed to be of little or no value in all events. Similarly, the cable rate freeze cases dealt with a highly unusual gap between regulatory regimes – Congress had passed a new law deregulating cable rates but provided customers an opportunity to demonstrate that cable rates in individual cities should remain regulated. The Commission instituted a temporary freeze to give customers a chance to file such submissions before cable firms took advantage of the new statutory regime to raise rates.[27] Thus, here again, the temporary cable rate freezes extended a scheme of Commission rate regulation and avoided undermining a new statutory regulatory regime – whereas here a freeze would disrupt a system of contractual negotiations and force the Commission to prescribe individualized contracts, without any record to support the necessary findings.

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[26] *See Special Access NPRM* ¶ 129.

[27] *Implementation of Sections of the Cable Television Consumer Prot. & Competition Act of 1992 Rate Regulation*, 8 FCC Rcd. 2921, ¶ 3 (1993) ("We are concerned that during the period between the adoption of our rules and the date that a local franchising authority can establish regulation of the basic service tier rates, and that consumers can file complaints with the Commission concerning potentially unreasonable rates for cable programming services, cable operators could raise rates, effectively undermining the statutory purpose of reasonable rates pending implementation of our rules.").

For similar reasons, Level 3's suggestion (at 23-24) that the Commission should refuse to entertain any new petitions for pricing flexibility during this proceeding would be arbitrary. Level 3's only basis for this suggestion is its claim that it is now "apparent" (*id*.) that the triggers do not correspond to competition – based on the same faulty "evidence" discussed above. Just as it would be arbitrary to mandate "interim" rates on the basis of this patently inadequate evidence, it would also be arbitrary to stop the application process of a fully valid and lawful program based on that evidence, before the Commission has even collected the data it is requesting.

Finally, the proposal to adopt an "interim" X-Factor of 5.3 percent is arbitrary for yet another reason.[28] The sole rationale for the number "5.3 percent" is that it was "the last productivity factor . . . that was adopted by the Commission and judicially upheld."[29] But that was *fifteen* years ago, and it was based on an estimate of historical productivity gains achieved by the LECs on an *enterprise* basis *in the late 1980's*, before the price cap regime was even adopted.[30] The Commission could not possibly base ratemaking decisions on such old and inapposite data, particularly since the only data in the record that addresses ILEC productivity gains for recent years is the study submitted by Embarq, which showed that productivity gains were in fact in line with the X-Factor that was actually in place.[31] Setting the X-Factor at 5.3

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[28] Sprint at 46 (citing its October 5, 2007 *Ex Parte* Letter in this proceeding).

[29] *See* Sprint at 46 n.146 (quoting *Special Access NPRM* ¶ 131).

[30] First Report and Order, *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd. 8961, ¶¶ 201-22 (1995) (adopting three X-Factor options, 4.0, 4.7, and 5.3 percent, based on corrections made in 1995 to estimates of productivity gains achieved from 1985-1989 prior to price caps). Sprint concedes this point: "[t]he 5.3 percent X-Factor proposed herein is not derived from recent data and was based on studies that were not focused on special access." *See Ex Parte Letter* from Christopher J. Wright and A. Richard Metzger (counsel for Sprint) to Marlene H. Dortch (FCC), WC Docket No. 05-25, Att. at 39 (Oct. 5, 2007).

[31] *See* Reply Comments of Embarq, WC Docket No. 05-25, RM-10593, Staihr Decl. ¶¶ 9-11 (Aug. 15, 2007). *See also* Carlton-Shampine-Sider Reply Decl. ¶ 73 ("Even if the 5.3 percent X-

percent today merely because the Commission used the same number fifteen years ago in a different context would be as arbitrary as throwing a dart at the wall.[32]

II. THE COMMENTS CONFIRM THAT THE EXISTING TRIGGERS BALANCE ACCURACY WITH ADMINISTRABILITY AND THAT THE ALTERNATIVES ADVANCED BY CRITICS WOULD NOT BE ACCURATE, ADMINISTRABLE, OR LAWFUL.

As AT&T demonstrated, the basic framework of the pricing flexibility regime – in which the Commission grants a measure of flexibility upon a showing of substantial sunk investment in competitive facilities – is not subject to any serious challenge.[33] Virtually all commenters, including opponents of the current rules, recognize the validity of the theory underlying pricing flexibility – *i.e.*, that it is in the public interest to give ILECs increased flexibility to respond to facilities-based competition.[34] Because the theory of pricing flexibility is sound, the only

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Factor was appropriate in 1995, opponents present no evidence that it would remain so today. There have been many changes in the industry over the past fifteen years, some of which would suggest a lower X-Factor").

[32] *See AT&T*, 449 F.2d at 451 (the Commission "apparently tried to avoid any direct challenge . . . by assuming that, even if the record were inadequate to allow it to make a definitive finding that the method it prescribed were just, fair, and reasonable, it could nonetheless choose among the alternative remedies discussed on the record and select the one which it believed to be the best. The fallacy of this assumption is obvious"); *see also Ill. Pub. Telecoms. Ass'n*, 117 F.3d at 565 (interim payphone rate of $0.35 unlawful because that figure not supported by the record evidence); *Time Warner Entm't Co. L.P.* v. *FCC*, 240 F.3d 1126, 1134 (D.C. Cir. 2001) (30 percent cap on cable ownership unsupported by the record).

[33] AT&T at 21-49.

[34] *See*, *e.g.*, Ad Hoc at 7 (the triggers would be appropriate if they identified "the presence of competitors providing special access services"); Level 3 at 5 (admitting that "[t]he theory that competitive pressures can ensure that special access rates, terms and conditions are just and reasonable may be true" and disputing only that the current triggers fail to do that); NoChokePoints at 17 (recognizing that the triggers are incorrect only insofar as that collocations are "not correlated with the number of competitive channel terminations" or "interoffice transport facilities"); Paetec at ii (criticizing the triggers only insofar as they may not, according to Paetec, be "an accurate proxy for the kind of sunk investment by competitors sufficient to constrain ILEC special access prices for channel terminations and dedicated transport facilities").

question here is an empirical one: whether the particular triggers the Commission has chosen are still reasonable proxies for sunk investment in competitive facilities.[35]

The comments leave no doubt with respect to that question. They show that extensive, competitive facilities-based networks exist wherever pricing flexibility has been granted. They contain a wealth of evidence that the pricing flexibility triggers are working as intended and that competitors are continuing to invest billions of dollars to deploy additional sunk facilities even outside dense downtown business districts where special access has historically been concentrated.[36] Indeed, they demonstrate that, if anything, the existing triggers have become dramatically *under*-inclusive in predicting the presence of price-constraining facilities-based competition because they fail to take into account significant competition that does not rely on collocation, including intermodal competition and competitors who avail themselves of collocation hotels.[37] Moreover, as Professor Carlton and others have stressed, there are enormous risks that any new Commission rules that attempt to dictate the "correct" price levels will miss the mark and send the wrong price signals to the marketplace.[38]

The potential cost of such regulatory errors would be particularly high, because slashing special access rates would inevitably have the effect of chilling investment by both ILECs and competitors in next-generation broadband facilities, precisely at a time when regulatory policy

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[35] *See, e.g.*, NoChokePoints at 17 (arguing that the Commission should gather data from non-ILEC competitors on the scope of their networks, because "[b]y analyzing these data, the Commission will be able to determine the extent to which the presence of collocated facilities in an MSA correlates with the presence of competition for channel terminations and interoffice transport").

[36] AT&T at 28-37; *id.*, Exhibit A, Declaration of Dennis W. Carlton and Hal S. Sider, ¶¶ 44-50 ("Carlton-Sider Decl."); Verizon at 18-27; Qwest, at 9-17.

[37] *See, e.g.*, AT&T at 28-38; Carlton-Sider Decl., ¶ 41; Qwest at 6; Verizon at 20-27.

[38] Carlton-Sider Decl. ¶¶ 35-40; Verizon, Attachment A, Declaration of Michael D. Topper, ¶ 61 ("Topper Decl.").

should seek to *maximize* those investments both to ensure the competitiveness of our nation and to provide jobs.[39] Given the compelling record evidence that today's special access regulatory framework is working as intended, coupled with the high risk that an alternate regime would send incorrect price signals, a rational regulator could certainly conclude on the existing record that embarking on what will necessarily be a lengthy and costly proceeding merely to "fine-tune" the pricing flexibility framework would undermine the Commission's National Broadband Plan and would be a poor use of Commission and industry resources.

If the Commission nevertheless moves forward with a reexamination of the pricing flexibility rules, it must do so on the basis of actual marketplace data that measure all relevant competition.[40] A data-driven approach that examines the full range of competition is the only economically and legally defensible approach.

Unfortunately, although the commenters that support increased regulation all pay lip service to these principles, many of the details of their proposals abandon those principles altogether. In particular, they urge the Commission to disregard entire categories of very real competition – including both intermodal competition and intramodal competition. They compound their errors by proposing analyses – building by building, floor by floor, circuit type by circuit type – that are not remotely administrable, presumably with the hopes that, while the Commission remains bogged down trying to implement their hopelessly complicated proposed framework, they would receive the benefit of interim relief. Some of these commenters insist on economic frameworks that are both misguided as a matter of economic theory and unworkable in any event. And many of these commenters wish to keep all of the competitive data submitted in

[39] AT&T at 13-21.

[40] AT&T at 21-44 & Carlton-Sider Decl. ¶ 43-50 & Carlton-Shampine-Sider Reply Decl. ¶¶ 40-47; Verizon at 9-30; Qwest, at 30-39. *See also*, *e.g.*, Level 3 at 14; Paetec at 54; Comments of TW Telecom, WC Docket No. 05-25, RM-10593, at 24 (Jan. 19, 2010) ("tw telecom").

this proceeding secret from all of the parties. The Commission should reject all of these attempts to gerrymander the results of the upcoming inquiry, and it should keep its eyes focused on the real question: whether the existing triggers are a *reasonable* and *administrable* proxy for the presence of substantial facilities-based competitors with sunk investment that cannot be driven from the marketplace.

The Commission Cannot Ignore Intermodal or Potential Competition. Many regulation proponents attempt to rig the results of the Commission's inquiry in their favor by arguing that the Commission should ignore entire categories of competition that are not only very real but growing in importance. There is no legal or factual basis for excluding these forms of competition from the Commission's pricing flexibility framework.

First, ignoring intermodal competition from wireless and cable providers altogether would be unlawful, and the courts have repeatedly reversed the Commission for practicing that sort of deliberate myopia. For example, the D.C. Circuit struck down the Commission's rule requiring unbundled access to "line sharing" for DSL services, because in its unbundling analysis the Commission "failed to consider the relevance of competition in broadband services coming from cable (and to a lesser extent satellite)."[41] Similarly, when the court reversed the Commission's horizontal ownership limits on cable operators, it faulted the Commission "in no uncertain terms" for failing to consider competition from satellite providers, and held that "in revisiting the horizontal rules the Commission will have to take account of the impact of DBS on [cable operators'] market power."[42] After the Commission failed to heed these instructions on

[41] *United States Telecom Ass'n* v. *FCC*, 290 F.3d 415, 429 (D.C. Cir. 2002) (unlawful for Commission to "inflict on the economy the sort of costs" associated with mandated unbundling with "naked disregard of the competitive context").

[42] *Time Warner Entm't Co. L.P.*, 240 F.3d at 1134; *see also Comcast Corp.* v. *FCC*, 579 F.3d 1, 6-7 (D.C. Cir. 2009).

remand, the D.C. Circuit struck down the horizontal ownership rule a second time last year, because the Commission relied only on satellite competition data that was six years old and did not consider the subsequent rise of competition from fiber optic providers at all.[43] Remarkably, the re-regulation proponents are asking the Commission to make exactly the same mistake again here. If the Commission were to ignore the undeniable fact that, since 1999, there has been a very substantial rise in competition from intermodal providers (which rise will inevitably continue in the coming years), that would be a sure recipe for quick reversal.[44]

Adopting a framework that ignores the substantial and rapidly expanding competition from cable and microwave wireless providers also has no factual basis.[45] For example, some commenters argue that customers do not view cable and wireless as viable alternatives to LEC special access facilities because, they say, cable and wireless lack the service level and quality provided by LECs, and, in any event, these commenters say, competition from cable and wireless is negligible. These claims fail at every level.

In fact, the record unequivocally confirms that customers do view cable and wireless as substitutes to LEC DSn-level services. The Commission's broadband workshops dramatically underscored that AT&T, Verizon, Qwest, Sprint, T-Mobile, Level 3, Clearwire and other large purchasers of special access services already purchase substantial amounts of DSn-level services from microwave wireless and cable providers, and that many of these carriers are also providers

[43] *Comcast Corp.*, 579 F.3d at 7 (Commission relied on "data from 1984-2001 and, as a result, fails to consider the impact of DBS companies' growing market share (from 18% to 33%) over the six years immediately preceding issuance of the Rule, as well as the growth of fiber optic companies").

[44] *See also id.* (even if "assessing competition from DBS companies is difficult," that "does not justify ignoring altogether a variable so clearly relevant and likely to affect the calculation of a subscriber limit").

[45] *See, e.g.*, tw telecom, at 11; Sprint at 19-20.

of wireless DSn-level services.[46] Indeed, Clearwire recently indicated that 90 percent of its wireless network is served by microwave backhaul, and it will be supplying backhaul for Sprint's 4G network.[47] And T-Mobile, which has ardently supported re-regulation of price-cap ILEC special access services, has conceded in testimony before the Commission that "competitive forces work in metro areas where there's a lot of fiber, be that from the cable company, from the existing, you know, telco provider."[48] Moreover, the record shows that cable

[46] *Ex Parte* Letter from Kathleen O'Brien Ham (T-Mobile) to Marlene H. Dortch (FCC), GN Docket Nos. 09-47, 09-51, 09-137, at 1 (Nov. 6, 2009) ("microwave facilities are used [by T-Mobile] mostly in rural areas"); Comments of Sprint, GN Docket No. 09-51, at 5 (Sept. 4, 2009) (Sprint's Clearwire network "will use self-provisioned microwave backhaul to handle the high-bandwidth requirements associated with 4G applications to the maximum extent possible."); Wireless Broadband Hearing, Tr. at 42-43 (Stelera Wireless founder and CEO Ed Evans) ("[w]e don't have a problem with back haul because we're using 300 MIP microwave off of those cell sites, so I've got plenty of back haul capacity to go back. So there's no issue there"); *See* Neville Ray, *National Broadband Plan Workshop*; Wireless Broadband Deployment – General Transcript, at 45-46 (Aug. 12, 2009) ("as you move to suburban fringe and rural areas, those [fiber] opportunities are much tougher to find, but there are good microwave solutions, as Ed [Evans, Stelera Wireless] mentioned, and some carriers are totally deploying their back haul solutions on a microwave basis"); Newby Hunter, *National Broadband Plan Workshop*, Deployment – Wired Transcript, at 30 (Aug. 12, 2009) ("it's the combination of fiber and microwave, which for backhaul from towers that don't have much fiber can cover a much larger swath of the country along this way"); Yankee Group 4G Network Backhaul Summit, *PowerPoint Presentation of CFN Services*, at 3 (Sept. 15, 2009) ("The higher your bandwidth requirements the more fiber you'll need; A 90% microwave architecture can safely support 50-100 Mbps per site today"); Supplemental Comments of AT&T Inc., *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, at 16-17 (Aug. 8, 2007) ("AT&T 2007 Comments") (AT&T's purchases of cable and wireless services); *id.*, attached Supplemental Declaration of Parley Casto ¶¶ 22, 25, 49-50 ("Casto Supp. Decl.") (AT&T's purchases of cable and wireless services); Comments of Verizon, *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, at 28 (Aug. 8, 2007) ("Verizon 2007 Comments") (Verizon's purchases of cable and wireless services); *id.*, attached Wells Decl. ¶¶ 6-7 ("2007 Wells Decl.") (Verizon's purchases of cable and wireless services).

[47] Yankee Group 4G Network Backhaul Summit, *PowerPoint Presentation of John Saw, CTO Clearwire* (Sept. 15, 2009) ("90% of Clearwire cell sites use microwave backhaul; Largest wireless backhaul network in North America"; "Rapid rollout," "Very low recurring costs," "Tremendous scalability, 50 Mbps – 1 Gbps of backhaul per site").

[48] Neville Ray, Senior VP Engineering, T-Mobile, FCC National Broadband Plan Workshop, Wireless Broadband Deployment -- General, Transcript at 45-46 (Aug. 12, 2009).

and microwave wireless providers have invested billions of dollars in network infrastructure precisely to take aim at backhaul and other traditional DSn customers, that they are achieving rapidly growing success, so much so that some of these providers have had difficulty keeping up with demand from the large volumes of customers they are attracting.[49]

Further, it is not even true, as tw telecom contends (at 16), that customers do not view basic cable modem service and wireless services offered on a best efforts basis as substitutes for

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[49] Steve Donohue, *Post Chapter 11, Charter Banks on Buz. Services*, Light Reading's Cable Digital News, December 4, 2009, *available at* http://www.lightreading.com/document.asp?doc_id=185425&site=cdn ("'We do not have the staff and resources right now to handle all of the cell backhaul requests coming from all of the towers going up in our footprint,' Fred Davies, Charter's director of IP architecture and product development, said here Thursday at the event's closing session. 'So we're ramping up to accommodate that, which is a good thing.'"); *Big Cable Operators Expect Large Commercial Service Revenue Gains*, Communications Daily, Jan. 5, 2010 ("Despite the steep recession, cable operators are increasing their share of the business telecom services market by winning revenue from small-to-midsized companies."); *id.* ("The five largest U.S. cable operators registered hefty increases in commercial services revenue over the first nine months of the year [2009]." With Comcast "commercial service revenue surg[ing] [by] . . . 49 percent," with Time Warner Cable and Cox "up by 15 percent," and each is very near the $1 billion total revenue mark); Jeff Baumgartner, *Cox Targets $2B in Biz Revenues*, Light Reading's Cable Digital News, December 3, 2009, *available at* http://www.lightreading.com/document.asp?doc_id=185383&site=cdn (Cox Communications reporting that its "business services division is on target to breach the $1 billion revenue mark in 2010, and has a batch of growth ideas on the way or in the works that will allow that number to double sometime during the next six years."); Comcast 4Q09 Earnings Call Transcript, Feb. 3, 2010 ("Comcast Q4 2009 Earnings Call Transcript"); US Telecom Report, at 11 (Cablevision has "invested more than $1 billion in the technology and infrastructure needed to build [its] . . . fiber optic network", which includes "more fiber in the [New York/New Jersey/Connecticut] tri-state area than any phone company," and which provides fiber service to twice as many buildings in its metropolitan New York footprint as Verizon does); *Id.* (Time Warner, Cox and Charter, frequently tout their extensive "high-capacity fiber networks" throughout the country that can accommodate "any industry."); Fibertower Presentation, Deutsche Bank Leveraged Finance Conference, at 6, 8, 10, September 30, 2009, http://www.fibertower.com/corp/downloads/investors/DB%20Deck%20093009%20final.pdf (describing Fibertower's "6 years as the leading alternative provider of high capacity cellular backhaul"; Fibertower has a "national footprint"; Fibertower has "customer agreements with the 9 top wireless carriers"); TTMI Website, http://www.ttmi.info/index.htm ("TTM serves hundreds of cell sites in each market. TTM eliminates the need for wireless carriers to commit capital to build out their own expensive backhaul infrastructure and is able to achieve the highest economies of scale with the latest technologies in any market.").

DSn services. As several commenters point out, the entry level best efforts services offered by cable and wireless at much lower prices than DSn services are more than adequate for many smaller businesses, and cable and wireless are targeting and winning such small and medium sized business customers.[50] In any event, it simply is not true that the services cable and microwave wireless providers actually market to business customers do not have guaranteed service levels similar to those offered with many LEC DSn-level services, as several commenters would have the Commission believe.[51] Intermodal competitors do indeed offer guaranteed service levels, fixed IP addresses, and symmetric upload and download speeds.[52]

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[50] *See, e.g.*, Tim McElgunn, Pike & Fischer, *Cable Commercial-Services Strategies*, at 4 (May 2007) ("Pike & Fischer has no doubt that the largest [cable] MSOs and many smaller operators will indeed achieve meaningful and rapid penetration into the $65 billion annual SMB revenue stream"); Sterling Perrin, Heavy Reading, *Cable vs. Telcos: The Battle for the Enterprise Market*, at 12 (Feb. 2006) ("SMEs – roughly speaking, companies employing between 10 and 499 people – are widely seen as the market sweet spot for the [cable] MSOs"); The Insight Research Corporation, *Cable Telephony: The Threat To Small Business ILEC Markets*, 200 7-2012 (April 2007); Bob Wallace & Paula Bernier, *Cablecos Voice their Business Strategies (*June 21, 2007), available at http://www.newtelephony.com/news/76h20193231.html ("Having established beachheads in many local markets, the five largest U.S. cablecos are launching a new offensive to attack the unprotected flank of incumbent telcos, and secure SMB customers"); *see also id.* ("The big five cablecos note that SMBs provide fatter margins than do residential customers, boast larger ARPU [average revenue per unit] and lower churn rates"); Peter Grant, The Wall Street Journal Online, *Cable Firms Woo Business In Fight for Telecom Turf* (Jan. 18, 2007), available at http://startup.wsj.com/runbusiness/relationships /2007011 8-grant.html?refresh=on ("Some cable-industry executives predict there are billions of dollars of new revenue to be made from serving business clients.").

[51] *See*, Tim McElligott, Inside the Cable Hemisphere, "Cox Business now serves 250,000 small and regional businesses, is the fourth largest provider of business Ethernet in the U.S. . . . 'We've earned the right to be called a trusted provider. We have delivered on our aspiration to be 'carrier grade.'" (quoting Philip Meeks, Vice President-Cox Business), Billing & OSS World, January/February 2010, *available at* http://www.billingworld.com/articles/inside-the-cable-hemisphere.html.

[52] *See, e.g.*, *See Towerstream, Service Level Agreement, http://www.towerstream.com/index.asp?ref=sla;* FiberTower Corp. et al., Petition for Reconsideration, *Unlicensed Operation in the TV Broadcast Bands*; *Additional Spectrum for Unlicensed Devices Below 900 MHz and in the 3 GHz Band*, ET Docket Nos. 04-186 & 02-380, at 2, n.3 (March 19, 2009) (describing FiberTower's service level agreements); *see also* Verizon at 26.

It is particularly curious that Sprint claims that "fixed wireless service is not a viable substitute for wireline special access services,"[53] when Sprint itself has committed to rely heavily on microwave wireless backhaul services. Sprint's 4G technology is based on WiMAX service that Sprint obtains from Clearwire, and, as noted, Clearwire has stated that it relies on microwave wireless to serve the vast majority of its backhaul needs.

Some commenters also urge the Commission to ignore much of today's *intra*-modal competition. They argue that the Commission should ignore potential competition and the dynamic nature of the special access marketplace, and should instead limit its focus to static market share data. This approach, too, would be unlawful. As the D.C. Circuit has already noted with respect to these very rules, "the FCC has long held that market share is not the be-all, end-all of competition" – rather, a "loss of market share is [not] necessary to prevent an incumbent LEC from raising prices," and "the presence of substantial sunk investment, and the resulting potential for entry into the market, can limit anticompetitive behavior by LECs."[54] This is hardly a novel proposition: court after court has held that static market share figures, by themselves, are not a sufficient basis to conclude that market power exists.[55] And ignoring

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[53] Sprint at 19.

[54] *WorldCom, Inc.* v. *FCC*, 238 F.3d 449, 458 (D.C. Cir. 2001).

[55] *Comcast Corp.*, 579 F.3d at 6 (whether a provider "can exercise 'bottleneck monopoly power' depends . . . 'not only on its share of the market, but also on the elasticities of supply and demand, which in turn are determined by the *availability* of competition'" (emphasis in original) (quoting *Turner Broad. Sys.* v. *FCC*, 512 U.S. 622, 661 (1994); *Time Warner Entm't Co.*, 240 F.3d at 1134); *Capital Cities/ABC, Inc.* v. *FCC*, 29 F.3d 309, 315 (7th Cir. 1994) (Posner, J.) (it has been "many years since anyone knowledgeable about" competitive analysis "thought that concentration by itself imported a diminution in competition"); *United States* v. *Gen. Dynamics Corp.*, 415 U.S. 486, 498 (1974) (market share is imperfect measure because market must be examined in light of access to alternative supplies); *United States* v. *Syufy Enters.*, 903 F.2d 659, 665-66 (9th Cir. 1990) ("In evaluating monopoly power, it is not market share that counts, but the ability to *maintain* market share.") (emphasis in original); *United States* v. *Baker Hughes, Inc.*, 908 F.2d 981, 986 (D.C. Cir. 1990) (market share statistics "misleading" in a "volatile and shifting" market).

potential competition would be even more indefensible here, because as Dr. Carlton has explained, in the special access marketplace such competition is really *actual* competition, given that facilities-based competitors often go against one another in competitive bidding for the right to build a particular connection.[56]

Just last summer, the D.C. Circuit reversed an order of the Commission denying forbearance from unbundling, because the Commission relied entirely on market shares and ignored potential competition.[57] As the court noted, "the FCC's apparent concern with only evidence of actual 'successful' competition, *i.e.*, existing market share percentages, rather than the existence of potential competition indicates that it considered market share to be the dispositive factor in its UNE forbearance analysis."[58] As the court held, however, this was a stark, unexplained departure from longstanding, consistent Commission precedent, because the Commission has always considered potential competition centrally important not only in forbearance proceedings,[59] but in any proceeding in which the question concerns the competitiveness of a marketplace.[60] And that is especially true in broadband marketplaces like

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[56] Carlton-Sider Decl. ¶ 63; Carlton-Shampine-Sider Reply Decl. ¶ 56-57.

[57] *Verizon Tel. Cos.* v. *FCC*, 570 F.3d 294, 301 (D.C. Cir. 2009).

[58] *Id.* at 302.

[59] *Id.* at 303 ("the FCC has consistently considered *both* actual and potential competition in assessing whether a marketplace is sufficiently competitive to warrant UNE forbearance"); *e.g.*, Memorandum Opinion and Order, *Petition of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metro. Statistical Area*, 20 FCC Rcd 19415, ¶ 35 (2005) ("*Omaha Order*"); Memorandum Opinion and Order, *Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended, for Forbearance from Sections 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, 22 FCC Rcd 1958, 1988 ¶ 45 (2007) ("*Anchorage UNE Order*").

[60] *See, e.g.*, *Covad Commc'ns Co.* v. *FCC*, 450 F.3d 528, 540 (D.C. Cir. 2006) (approving unbundling order because Commission "repeatedly justifies its unbundling determinations on the basis of both actual *and potential* competition") (emphasis in original); *Triennial Review Remand Order*, 20 FCC Rcd 2533, ¶ 87 (2005) (unbundling unnecessary where conditions indicate that "reasonably efficient competitive LECs are *capable* of duplicating the incumbent

special access, which are characterized by constant, dynamic change in both competition and technology.[61]

Ignoring potential competition would also be an enormous factual error. For example, Level 3 insists that the Commission should use a building-by-building approach, and should focus only on "lit" "on-net" buildings because, Level 3 says, it is not economically feasible for competitors to compete for customers in buildings to which they do not already have connections.[62] This is completely false and paints a very distorted picture of how special access competition works. Indeed, the Commission, the Department of Justice, the D.C. Circuit, and

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LEC's network" (emphasis added)); *AT&T Nondominance Order*, 11 FCC Rcd. 3271, ¶ 68 (1995) ("It is well-established that market share, by itself, is not the sole determining factor of whether a firm possesses market power. Other factors, such as demand and supply elasticities, conditions of entry and other market conditions, must be examined to determine whether a particular firm exercises market power in the relevant market"); Order and Notice of Proposed Rulemaking, *Petition Pursuant to Section 10(c) of the Communications Act of 1934, as Amended, for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier*, 13 FCC Rcd 14083, 14123 ¶78 (1998) ("*Comsat Order*")).

[61] *See, e.g.*, *EarthLink, Inc.* v. *FCC*, 462 F.3d 1, 8 (D.C. Cir. 2006); *Time Warner Telecom, Inc.* v. *FCC*, 507 F.3d 205, 221 (D.C. Cir. 2007) (acknowledging Commission's need to "refrain from a traditional market analysis and to rely instead on larger trends and predictions concerning the future of the broadband services market").

[62] Level 3, at 13-16; *see also* Paetec, at 55. Level 3 asserts that it lacks non-ILEC alternatives for DS3 services in the vast majority of commercial buildings with "significant" demand in the Chicago MSA. Level 3 contends the universe of "significant" buildings in Chicago relevant to its DS3 assertion is 71,000 buildings, but according to AT&T's records, it provides DS3 or higher level services to less than a tenth of that number of buildings in the Chicago MSA. Another obvious problem with Level 3's numbers is that the number of non-ILEC buildings it reports are only those that are already "competitively served" by non-ILECs and thus fails to account for the buildings where competitors do not yet have connections but are vigorously competing to provide service. Level 3 ultimately concedes that the Commission cannot draw conclusions without first collecting data. Level 3, at 13. Similarly, XO claims that it and other ACTel members performed an analysis in 2005 in the Bell company merger proceedings that purported to show a diminution in competition from those mergers. Even if that sort of merger-related analysis were relevant here, the Department of Justice *did not accept* ACTel's data or conclusions – indeed, XO spends lengthy footnotes (at 4 n.10 & 5 n.13) arguing against the analysis that the Justice Department actually used. The Tunney Act court specifically held that the Justice Department's approach was reasonable. *United States* v. *SBC Communications*, 489 F. Supp. 2d 1, 18-23 (D.D.C. 2007).

competitors themselves have recognized that special access competition does not occur merely or even primarily among carriers that *already* have an existing connection to a building.[63]

Special access competitors compete for long-term contracts to serve a particular location, a strategy that allows them to deploy direct connections only after winning the contract, rather than assuming the substantial risk of deploying ubiquitous connections first and trying to win the business later[64] – as price cap ILECs often must do under their carrier of last resort and other service obligations. CLECs therefore deploy large fiber rings or other transport facilities and then make bids and offers to serve special access demand for customers in buildings located near their networks,[65] and cable and fixed wireless providers likewise have facilities that readily can

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[63] *See, e.g.*, Memorandum Opinion & Order, *AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, 22 FCC Rcd. 5662, ¶ 36 (2007) (describing DOJ and FCC analysis that found buildings to be subject to competition where there were demand and cost characteristics such that entry would be likely should the merged entity attempt to raise prices after the merger"); *United States Telecom Association* v. *FCC*, 290 F.3d 415, 428 (D.C. Cir. 2002) (reversing Commission because it "failed to consider the relevance of competition in broadband services coming from cable (and to a lesser extent satellite)"); tw telecom, Investor Presentation, at 8, June 2009 (discussing tw telecom's market opportunities and describing its "target buildings" as those "within 1 mile of TWTC's fiber" with two or more DS1 bandwidth utilization.).

[64] *See, e.g.*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exch. Carriers; Implementation of the Local Competition Provisions of the Telecomms. Act of 1996; Deployment of Wireline Services Offering Advanced Telecomms. Capability*, 18 FCC Rcd. 16978, ¶ 316 (2003) (customers often "enter into long-term contracts committing to revenue streams and associated early termination charges that provide the ability for carriers to recover their substantial non-recurring 'set-up' or construction costs" of deploying facilities).

[65] *See, e.g.*, Level 3, Informational Investor Presentation, at 7 (May 7, 2009), *available at* http://files.shareholder.com/downloads/LVLT/410073203x0x296047/425b109c-bb88-4e29-82be-95e94218b23c/Investor%20Presentation_Mid%20May%202009.pdf. ("[o]ver 100,000 enterprise buildings within 500 ft of [Level 3's] US network."); tw telecom, Investor Presentation, at 8 (May 9, 2009), *available at* http://www.twtelecom.com/Documents/Investors/Presentations/2009/TWTC_May_09_Investor_Presentation_.pdf. (estimated that of the approximately 1.9 million "target" businesses (*i.e.*, sites with 2 or more DS-1s of bandwidth) in the cities it serves, nearly one million are within one mile of tw telecom's fiber").

be used to provide connections to additional customers (indeed, it is AT&T's understanding that wireless carriers rarely deploy facilities to a building before it wins a customer there). Although this is often referred to as potential competition (because the competing firms have not yet built the direct connection), this form of competition is really *actual* competition and is commonplace in the special access marketplace.[66] This is why Level 3 and other alternative providers advertise to potential customers and report to investors the number of buildings that are *near* their fiber. If CLECs could not (or were unwilling to) extend laterals to such buildings, such marketing materials and investor presentations would be highly misleading. The competition that occurs for long-term contracts is particularly intense even when there are no existing competitors with facilities to the location at issue because, as Dr. Carlton explains, in a marketplace like special access, which is characterized by high fixed costs and low marginal costs, the benefits of winning or retaining a customer are high, and the costs of losing a customer are large (because the result is stranded costs).[67] Accordingly, competitors compete fiercely either to retain or to win away a customer on any given route, to retain or to capture those benefits, resulting in robust competition even at locations that are currently served by only one facilities-based competitor.[68] That is why the Department of Justice and the Commission have expressly found that competition from traditional CLECs constrains ILEC prices in any building that is sufficiently near, but not necessarily already connected to, their competitive sunk network facilities.[69]

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[66] *See, e.g.*, Carlton-Sider Decl. ¶ 63; Carlton-Shampine-Sider Reply Decl. ¶ 56-57.

[67] Carlton-Sider Decl., ¶ 98.

[68] Carlton-Sider Decl. ¶ 63; Carlton-Shampine-Sider Reply Decl. ¶ 56-57.

[69] See, e.g., Memorandum Opinion and Order, AT&T Inc. and BellSouth Corp. Application for Transfer of Control, 22 FCC Rcd. 5662, ¶¶ 41-42, 46 & nn.111-14 (2007) (describing and adopting "screens" employed by DOJ to determine whether a building could be served by alternative facilities, which recognize that competitors with facilities near a building can and do compete for customers in that building).

It also is important to note that just as CLECs may not currently have high capacity facilities to all buildings, the same is often true of ILECs. That is because the enterprise and carrier customers that purchase special access services increasingly are demanding higher bandwidth and Ethernet services that require ILECs to construct new laterals or other network extensions to reach customers' locations. In these situations, CLECs have the same opportunity as incumbents to deploy new facilities to provide high capacity services.

In any event, even where an ILEC has facilities to a particular location or customer, and it is not feasible for a CLEC to quickly deploy its own, it is simply not the case that the CLEC cannot compete to serve that location or customer. In that event, the CLEC can serve the customer or location using UNEs (either copper loops to which it can attach its own electronics or DSn level services in the vast majority of wire centers in which such facilities still must be unbundled) or ILEC special access services while it extends its own network to that location or customer.[70] Thus, unlike the ILEC, which must be willing to serve all customers and all locations (irrespective of demand) in order to fulfill its carrier of last resort and other service obligations, a CLEC can selectively deploy facilities only where it already has signed up a customer, and thus is guaranteed a return on its investment.[71]

[70] In so doing, the CLEC can utilize the ILEC's conduit, ducts and rights of way, and thus can avoid many of the costs incurred by the ILEC in deploying its network.

[71] CLECs have argued that the Commission should disregard competition from CLECs reselling ILEC special access services because resale of ILEC special access services is not profitable or otherwise financially viable. But even if that were true (and it is not), the mere fact that a CLEC cannot profitably serve a particular customer or location by reselling the ILEC's services is beside the point. That is because in a networked business, such as telecommunications, where service providers offer services at uniform rates irrespective of the cost of providing service to a particular customer or location, not all routes or locations will be profitable. What matters is whether a service provider is able to earn a reasonable return on its overall investment, not whether it can make a profit on every route. Thus, even if a CLEC merely can break even (or if its costs marginally exceed its revenues) by serving a particular customer or location using ILEC

The Commission Must Maintain Pricing Flexibility Triggers That Are Administrable. Given the opportunity to suggest an "analytical framework" for assessing the pricing flexibility rules, many re-regulation proponents argue for approaches that have a veneer of analytical rigor and a return to "first principles."[72] These commenters spend an enormous number of pages describing more "accurate" approaches to analyzing the special access marketplace that are, in most cases, absurdly granular. Despite the copious verbiage expended in these discussions, however, none of this yields any remotely *useful* analytical framework that the Commission could actually use in this proceeding.

For example, virtually all of these commenters begin by arguing that the relevant geographic market is each point-to-point route serving each individual building (or even individual *floors* of buildings).[73] To state the obvious, however, a building-by-building or floor-by-floor approach to pricing flexibility is neither workable nor required – as the Commission, the

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services to fill in gaps in its network, that does not mean the CLEC cannot compete effectively with the ILEC.

[72] The Commission should recognize these calls to "return to first principles" for what they are – a blatant attempt to shift their burden of proving the need, if any, for reform of the Commission's special access pricing flexibility regime and to require the ILECs to prove again that they should receive such flexibility – as if the past decade of increasing competition, expanded output and lower prices had never occurred. They thus seek to shift the focus away from their failure to show that the Commission's existing pricing flexibility is not working as intended – notwithstanding having had multiple opportunities to do so – and that some other framework would better balance and achieve the full-range of the Commission's broadband objectives. As we explained in our opening comments, the Commission is not writing on a blank slate here. AT&T Comments at 6. The Commission's pricing flexibility framework has been in place for a decade, and it is incumbent on those that would alter that framework to justify any changes. Recognizing that the weight of the evidence in the record is against them, they now ask the Commission to ignore all that evidence and adopt a new framework for assessing special competition that would place the onus on price cap LECs to justify continued pricing flexibility under standards that would be impossible to meet.

[73] *See*, *e.g.*, Ad Hoc, at 10 (analysis should be conducted by "individual buildings or even individual floors"); Level 3, at 13 (advocating a "building-by-building analysis"); NoChokePoints, at 7 (the Commission should examine "individual buildings and cell sites"); Paetec, at 27 (advocating a "building-specific test").

DOJ and the courts have all repeatedly recognized, it is both appropriate and lawful to employ broader geographic analyses where relevant competitive conditions are roughly equivalent. Indeed, courts have insisted that the definition of a geographic market must be large enough to be meaningful and practicable.[74] Moreover, proponents of these ultra-granular approaches ignore that any rational building-by-building rule would have to be based on whether a building feasibly *could be* served by competitors, not whether a building currently happens to be served by a competitor.

For all its purported rigor, this mode of analysis leads all of these commenters into an intellectual dead-end. After wasting pages on these explanations, virtually all of these commenters acknowledge that such granular approaches would be administratively unworkable, and they concede the Commission will have to resort to a much more aggregated approach.[75] But having essentially retraced the Commission's own analysis when it chose the MSA-wide triggers in 1999, these commenters stop short of that obvious conclusion, and indeed, most of

[74] *See, e.g.*, *Wampler* v. *Southwestern Bell Tel. Cos.*, 2010 WL 597245 (5th Cir., Feb. 22, 2010) ("given the competition that exists between [building] owners [for tenants], the competition that exists between service providers, and given the highly mobile nature of today's society, we cannot hold that a single MDU [building] is so segregated as to be economically significant and thus represents a plausible geographic market"); *id.* ("Plaintiffs' alleged geographic market of MDUs essentially identifies specific venues (collections of apartment homes) that simply narrow the broader economic market in which these MDUs are located, which in this case is the City of San Antonio").

[75] *See, e.g.*, Paetec at 35 ("for reasons of administrability, the Commission might aggregate the geographic market for loops to the wire center level"); Sprint at 9-10 ("As the Commission recognized . . . 'assessing market power in each individual point-to-point market would be administratively impractical and inefficient.' . . . Accordingly, the Commission may conclude that administrative feasibility requires it to aggregate the individual geographic markets into broader categories for purposes of assessing the need for pricing flexibility"); NoChokePoints at 8 ("However, if the Commission determines that conducting an analysis focused on individual buildings would be not be practicable, the Commission can further aggregate similarly situated point-to-point connections or use a sampling method.").

these commenters stay silent rather than offer any concrete geographic alternative for the scope of pricing flexibility relief.

More fundamentally, however, none of these commenters' analyses calls the current MSA-wide triggers into question either theoretically, factually, or practically. Special access demand tends to be very concentrated and given that Phase II relief for channel terminations has been granted only after there are fiber-based collocations in wire centers that account for 85 percent of the ILEC's revenues in the MSA (65 percent for transport), the impact of any geographic mismatch is guaranteed to be minimal. The effects of the pricing flexibility rules are further mitigated because the ILECs must file their negotiated contracts as tariffs that make competitive rates available throughout an MSA, and pricing of special access services tends to be uniform throughout an MSA. Indeed, special access customers typically insist on uniform pricing and terms, for their own convenience.

To the extent transport costs may be higher in rural areas, that is a consequence of the longer distances and lower population densities in those areas – the per-mile pricing of special access is almost always uniform throughout an MSA.[76] To the extent there is a problem there, the answer is not re-regulation and more granular, more administratively burdensome pricing flexibility triggers. Rather, the Commission should recognize that new technologies, like wireless microwave, are flowing into these areas as alternatives, and the Commission can boost those efforts with competitively and technologically neutral subsidy mechanisms, such as those

[76] *See*, *e.g.*, Comments of AT&T Inc. – NBP Public Notice # 11 COMMENTS – NBP PUBLIC NOTICE # 11, GN Docket Nos. 09-47, 09-51, 09-137, at 4-5 (Nov. 4, 2009); *see also*, *e.g.*, Berge Ayvazian (4G World Co-Chair and Senior Advisor, Yankee Group) & Dr. Alan Solheim (VP, Product management, DragonWave), Optimizing Backhaul to Address 4G Challenges, at 32 (Nov. 17, 2009) ("The main advantage for fiber is its essentially limitless capacity" but "[a] key difference in business case: fiber builds are distance & population density sensitive vs. relatively fixed cost for microwave").

proposed under the Broadband Stimulus plan. Artificially decreasing ILEC rates in these areas will only discourage competitive investment, undermining the Commission's broadband priorities.

Other commenters, such as NoChokePoints (at 9-11) and BT (at 11-13), suggest that the Commission should slice up the pricing flexibility triggers by service, and re-regulate all services below a certain bandwidth, leave other services subject to pricing flexibility, and continue to investigate the services in between. There is no merit, however, to assertions that the Commission can simply assume that no CLEC serves DS1 circuits using facilities associated with a facilities-based network, and that the Commission should thus eliminate pricing flexibility for *all* DS1 services.[77] First, it is indisputable that CLECs specifically offer facilities-based DS1 level services to customers in their service territories.[78] Second, it is addressable building demand, and not the size of an individual circuit that may be supplied to a particular customer in the building, that drives facilities investment decisions, and DS1s are routinely provided in buildings with much higher total addressable demand. Third, competition for DS1 services often occurs in the context of a customer with multiple locations, some with higher capacity demand and some with DS1 capacity demand. In these common competitive bidding situations, investment decisions may be driven by the overall revenue opportunity and not the opportunity at

[77] *See*, *e.g.*, NoChokePoints at 16.

[78] *See*, *e.g.*, Level 3 Website, http://www.level3.com/index.cfm?PageID=51 (offering "[a]vailable speeds [that] include DS-1, DS-3, OC-3/3c & STM-1, OC-12/12c & STM-4/4c, OC-48/48c & STM-16/16c, and OC-192"); XO Website, http://www.xo.com/services/network/Pages/private-line.aspx ("Choose from several high-capacity bandwidth options including DS-1 (1.5 Mbps), DS-3 (45 Mbps), and OC-N"); Paetec Website, http://www.paetec.com/products-services/data/dedicated-internet-access/overview.html (offering "[e]conomical sub-T-1 speeds for small businesses, and speeds from 1.5 Mbps to OC-n or GigE for those with higher bandwidth demands"); tw telecom, Investor Presentation, at 8, June 2009 (discussing tw telecom's market opportunities and describing its "target buildings" the 1 million buildings that are "within 1 mile of TWTC's fiber" with two or more DS1 bandwidth utilization.).

one particular location. Fourth, NoChokePoint's argument, by focusing solely on CLECs, ignores that cable companies and wireless companies are specifically targeting customers with lower-capacity demand. Thus, there is no basis whatsoever to contentions that the Commission can simply assume, without even looking at the data, that there is no significant competition for lower capacity services.[79]

The Commission Should Reject Other Economically Inappropriate Approaches. Finally, a number of commenters, including Paetec and tw telecom, propose frameworks that are derived from the Justice Department's Merger Guidelines, and urge the Commission to use those approaches to determine product markets or to fashion frameworks based on market shares and the Herfindahl-Hirschmann Index ("HHI"). As Dr. Carlton explains, these techniques are not even theoretically appropriate in this context; the Guidelines, and the HHI, are merely tools to assess changes in concentration that arise from a merger, and even then they are merely initial screens that are used to determine whether further inquiry is warranted.[80] The Commission has cautioned that higher HHIs are to be expected in an industry with the technological and economic characteristics of telecommunications.[81] Few capital-intensive industries sustain an HHI below 1800, yet many such industries, including special access, are intensely competitive.

[79] *See also* Carlton-Shampine-Sider Reply Decl., ¶ 59.

[80] *See id.*, ¶¶ 61.

[81] *See, e.g.*, Ninth Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*, WT Docket No. 04-111, ¶ 55 (Sep. 9, 2004) ("*Ninth Wireless Report*") ("In industries where the scale of output at which a firm can fully exploit scale economies (the minimum efficient scale) is large relative to potential demand, there will be room in the market for only a small number of firms operating at the lowest possible cost. In theory, therefore, market concentration in such industries will tend to be high relative to industries characterized by greater potential demand or smaller minimum efficient scale").

As the Commission itself has repeatedly recognized, a "high" market concentration alone does not demonstrate a lack of competition.[82]

In any event, given the structure of ILEC costs, and the risk of stranded investment, even a small number of competitors would have a powerful restraining effect on ILEC pricing because the loss of even a small number of customers would have a significant impact on ILEC profits. Consequently, any evaluation of market shares, HHIs, or similar methods of measuring concentration or the structure of the special access market is almost certain to be misleading and more trouble than it is worth.

The Commission Must Maintain the Integrity of the Analysis By Exposing Its Data To Scrutiny. NoChokePoints (supported by several other commenters) repeats its request that whatever competitive network data the Commission collects in this proceeding be kept secret,[83] not just from the public, but from all of the parties as well, even attorneys and experts who have agreed to abide by the terms of a strict protective order. To the extent such an approach would preclude public scrutiny and comment on the data on which the Commission will rely in its decision in this proceeding, it would make a mockery of this Commission's commitment to openness, as well as violate established confidentiality policies and precedents and the Administrative Procedure Act's standards for informed participation in rulemaking proceedings.

This is a rulemaking proceeding, and hiding key data from the parties would flatly violate the Administrative Procedure Act. The courts have repeatedly held that 5 U.S.C. § 553, which governs rulemakings, requires agencies to disclose "at least the most critical factual material that

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[82] *See Ninth Wireless Report* ¶ 55 ("it is worth noting that the economic literature does not provide a theoretical or empirical basis for the existence of any critical threshold level of concentration above which adverse competitive effects are likely").

[83] NoChokePoints at 36-38; Level 3 at 18; Comments of XO Commc'ns, LLC, WC Docket No. 05-25, RM-10593, at 12-14 (Jan. 19, 2010) ("XO").

is used to support the agency's position" in order to expose this material "to refutation"[84] – which includes both "the 'technical studies *and data*' upon which the agency relies."[85] As the courts have explained, full "disclosure of *staff reports* allows the parties to focus on the information relied upon by the agency and to point out where that information is erroneous or where the agency may be drawing improper conclusions from it."[86] Moreover, Section 553 must be read in tandem with Section 706 of the APA, which requires the court of appeals to review any new rules on the basis of "the whole record." There cannot be any meaningful judicial review of agency action based upon a study and underlying data that have not been vetted in the comment process and, indeed, where aggrieved parties do not even have enough information to know whether the agency's reliance on the data is subject to a proper challenge.[87]

Accordingly, when data is competitively sensitive, the Commission has a longstanding policy that such information should be submitted under a strict protective order, not withheld from the commenting parties altogether.[88] The Commission already has a robust protective order

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[84] *Chamber of Commerce of the United States* v. *SEC*, 443 F.3d 890, 900 (D.C. Cir. 2006) (internal quotation marks omitted); *id.* at 901 ("By requiring the most critical factual material used by the agency [to] be subjected to informed comment, the APA provides a procedural device to ensure that agency regulations are tested through exposure to public comment, to afford affected parties an opportunity to present comment and evidence to support their positions, and thereby to enhance the quality of judicial review") (internal quotations omitted).

[85] *Id.* at 899 (emphasis added) (quoting *Solite Corp.* v. *EPA*, 952 F.2d 473, 484 (D.C. Cir. 1991)); *see also Portland Cement Ass'n* v. *Ruckelshaus*, 486 F.2d 375, 393 (D.C. Cir. 1973) ("It is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data, or on data that, [to a] critical degree, is known only to the agency").

[86] *NARUC* v. *FCC*, 737 F.2d 1095, 1121 (D.C. Cir. 1984).

[87] *Am. Radio Relay League* v. *FCC*, 524 F.3d 227, 243 (D.C. Cir. 2008) (Tatel, J., concurring) (sufficient evidence must be disclosed "for petitioners to mount a substantial evidence challenge, and for [the court] to resolve it in any meaningful sense").

[88] *See* Report & Order, *Examination of Current Policy Concerning the Treatment of Confidential Information Submitted to the Commission*, 13 FCC Rcd. 24816, ¶¶ 43-44 (1998). For example, in recent merger proceedings, the Commission collected raw data identifying "buildings that: (1) are vacant or have [a merger applicant or affiliate] as the sole tenant; (2) are currently served by

in this proceeding that is designed to address precisely the concerns NoChokePoints is raising.[89] Notably, XO (at 13-14) expressly concedes that a protective order would be fully adequate to protect this "most competitively sensitive information that a firm possesses."

NoChokePoints nonetheless maintains that even an appropriately tailored protective order would not address its confidentiality concerns. It claims, in this regard, that re-regulation proponents will refuse to cooperate with the Commission's investigation unless the Commission assures their data complete secrecy. But these are the parties who are asking the Commission to repeal twenty years of precedent. If they are not prepared to vet their data that purportedly supports their proposals through normal administrative processes, they should withdraw their claim. Assertions on their part that those processes, which are good enough for everyone else's data but not good enough for them, are inadequate for the instant proceeding ring hollow. The Commission has repeatedly held that it "retain[s] ample authority to address a misuse of information obtained under a protective order,"[90] and as XO makes clear (at 13), the Commission "has the legal authority to compel production of the data pursuant to Section 211 of the Communication Act." NoChokePoints' argument rings especially hollow considering that these parties routinely provide the same types of information to price cap LECs in the ordinary course of business, disclosing it subject to non-disclosure agreements that are no more restrictive

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other competitive LECs with direct connections; and (3) have demand and cost characteristics such that entry would be likely should the merged entity attempt to raise prices after the merger." Memorandum Opinion & Order, *AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, 22 FCC Rcd. 5662, ¶ 36 (2007).

[89] *See* Order, *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, 20 FCC Rcd. 10160 (June 8, 2005) ("*Order Adopting Protective Order*").

[90] *Id.* ¶ 6; Report and Order and Notice of Proposed Rulemaking, *Implementation of the Cable Television Consumer Protection Act of 1992*, 22 FCC Rcd. 17791, ¶ 103 (2007) ("[t]he Commission has full authority to fashion appropriate sanctions for violations of its protective orders").

than Commission protective orders.[91] And the need for access to any underlying data they do provide is manifest: when special access competitors submitted similar information to the Justice Department during recent merger reviews, the merger applicants discovered numerous errors in that information.[92]

Second, NoChokePoints argues that agency secrecy will allow "*all* members of the public to review and comment on the [aggregated] data that the Commission will rely on, including those who are barred from reviewing confidential submissions under the terms of the protective order." But it could be impossible to verify the accuracy of aggregate data without access to the data underlying it. And, of course, all members of the public could still comment on the Commission's aggregated, non-confidential analysis even if – as the APA requires – the parties are permitted to review and comment on the confidential data subject to an appropriate protective order.

NoChokePoints (at 37 & n.80), adopting arguments made by Sprint in an earlier *ex parte* letter, purports to find "authority" for its position in a passage from the summary of argument in a Commission appellate brief in *Echostar Satellite, L.L.C.* v. *FCC*, 457 F.3d 31 (D.C. Cir. 2006). That case, however, provides no support for NoChokePoints' position. There, a party had submitted a study but not the underlying raw data. Accordingly, in that case the Commission itself had no access to the data at issue. The Court held simply that where the Commission had *not* conducted its own study but merely had its own "cogitations upon the evidence in the record," as it would in any proceeding, the agency was entitled to give the study whatever weight it merited in light of the party's explanation of its methodology.[93] The D.C. Circuit has

[91] AT&T Reply, Casto Supp. Reply Decl., WC Docket No. 05-25, ¶¶ 4-6 (filed Aug. 15, 2007).

[92] *See, e.g.*, Carlton-Sider-Shampine Reply Decl. ¶ 65.

[93] *Echostar Satellite L.L.C.* v. *FCC*, 457 F.3d 31, 39-40 (D.C. Cir. 2006).

subsequently distinguished *Echostar* from a situation like this one, in which the Commission possesses and relies upon the relevant data but refuses to make that data available to commenters.[94]

Indeed, that case, *American Radio Relay League* is directly on point and establishes beyond doubt that the NoChokePoints secrecy proposal would be unlawful. In that case, the D.C. Circuit remanded a Commission rulemaking order redacting data underlying a Commission study, holding that "the Commission can point to no authority allowing it to rely on the studies in a rulemaking but hide from the public parts of the studies that may contain contrary evidence, inconvenient qualifications, or relevant explanations of the methodology employed."[95] Sprint claims that, even under *American Radio Relay League*, the Commission could keep its data secret as long as it does not "redact information tending to undermine whatever rules it proposes," but Sprint misses the point of this entire line of cases: without making the data available for comment, neither the parties nor a reviewing court can determine whether the "information is erroneous or where the agency may be drawing improper conclusions from it."[96]

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[94] *See Am. Radio Relay League*, 524 F.3d at 238 (*Echostar* "is inapposite" because the materials at issue "were never fully disclosed for comment even though they were, according the Commission, a central source of data for its critical determinations"). For the same reasons, Sprint also misreads *Am. Public Commc'ns Council* v. *FCC*, 215 F.3d 51, 58 (D.C. Cir. 2000), finding that which also stands for the proposition that, when a party submits data and the *party* chooses not to provide underlying support, the Commission is entitled to give such a submission whatever weight it deserves in light of its limitations.

[95] *Am. Radio Relay League*, 524 F.3d at 239; *see id*. at 239, 240 ("no precedent sanctions such a 'hide and seek' application of the APA's notice and comment requirements," and directing the Commission on remand to make available for notice and comment "the unredacted technical studies *and data* that it has employed in reaching its decisions" (emphasis added and internal quotation marks omitted)).

[96] *NARUC*, 737 F.2d at 1121.

NoChokePoints' proposal thus would not only belie the new Commission's commitment to "unparalleled" openness and transparency,[97] it would be unlawful.

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In short, much of the regulation proponents' analysis proceeds from entirely the wrong legal construct, because they assume that the issue in this proceeding is whether the price cap LECs are dominant in their provision of special access services. Based on this assumption, these commenters spend many pages arguing about geographic markets, market shares, and other complex economic issues that the Commission would have to face in any nondominance proceeding. But as the D.C. Circuit has previously recognized, that is not the issue here. Indeed, the regulation proponents arguments' have advanced not a whit in ten years: now, as then, the regulation proponents "offer no alternative [to collocation-based triggers] save a painstaking analysis of market conditions such as that which is required when a LEC seeks classification as a nondominant carrier or the forbearance of dominant carrier regulation."[98] But the Commission was "seeking an alternative" to forbearance that would provide some partial regulatory relief *without* having to resort to a full-blown nondominance proceeding, and for that reason the fact that the Commission "chose to rely on an admittedly imperfect measure of competition does not render its use arbitrary and capricious."[99] Thus, the issue remains solely whether the "FCC's proxy is reasonable" for the more limited purpose of granting pricing flexibility.[100] It does not appear to have occurred to the re-regulation proponents that, if the Commission were to actually

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[97] National Broadband Plan Process, FCC Open Meeting July 2, 2009, Statement of Chairman Genachowski (lauding roadmap for broadband proceeding that will be "open, transparent, and will allow public participation in ways that are unparalleled for this agency").

[98] *WorldCom, Inc.*, 238 F.3d at 459.

[99] *Id.*

[100] *Id.*

undertake a nondominance analysis, the result of that inquiry would be the complete deregulation of the ILECs' special access services, not merely adjustments to the triggers or the price caps.[101]

Thus, the proponents of increased regulation waste an enormous amount of ink in these comments explaining approaches that the Commission could never really adopt or apply.[102] But these commenters are completely missing the point of the pricing flexibility regime. The rules do not grant ILECs complete deregulation of their rates, but merely a measure of flexibility to respond to the confirmed existence of facilities-based competitors. Therefore, as the Commission has always recognized, the pricing flexibility triggers do not need to achieve pinpoint accuracy – they need only to be a *reasonable* proxy for the sunk facilities-based alternatives that justify relief. The question here, as AT&T has maintained from the beginning, is a simple empirical one: whether the Commission's administrable, collocation-based triggers reasonably correspond to the presence of sunk, facilities-based competitors.

III. THE COMMENTS ESTABLISH THAT THE EXISTING PRICE CAPS PRODUCE JUST AND REASONABLE RATES, THAT ARMIS DATA IS MEANINGLESS AND THAT THERE IS NO BASIS TO INSTITUTE COMPLEX PROCEEDINGS TO ESTIMATE THE ILECs' SPECIAL ACCESS "PROFITS" OR CALCULATE A SPECIAL ACCESS "X-FACTOR."

The comments also confirm the bedrock principle that the Commission cannot reasonably rely on accounting (or other) measures of special access "profits" as a framework for assessing

[101] For similar reasons, BT's effort to import Ofcom's analysis of British high capacity services has no place in this proceeding. Ofcom's inquiry was focused entirely on whether any carrier had "significant market power" – an analysis that Ofcom conducted literally on a zip code by zip code basis under a European legal standard that places greater weight on market share than would be permissible under American law. *See* Ofcom, *Business Connectivity Market Review, Consultation* (Jan. 2008), at 205-08. Even putting aside differences between the U.S. and UK markets, market power is not the relevant inquiry in this pricing flexibility proceeding.

[102] This appears to be central to their strategy, which is to shift to price cap ILECs the burden of justifying continued pricing flexibility under a framework that would straightjacket the ILECs and thus ensure that they (the proponents of re-regulation) receive a government mandated price break.

whether incumbents' special access DSn rates are just and reasonable in areas that remain subject to price caps.[103] As the commenters point out, the entire purpose of the price cap system is to sever the link between an ILEC's prices and its costs and profits.[104] Ad Hoc is the only commenter that even attempts a substantive defense of relying on "profits" or ARMIS data, but as shown below its arguments are meritless. Similarly, the Commission could not rationally rely on the various apples-to-oranges rate comparisons that have been proposed, each of which would be either starkly inappropriate or administratively impractical. Nor is there any sound basis for trying to determine a new X-Factor, when the only study in the record confirms that the current X-Factor is appropriate.

Indeed, the potential error costs of reinitializing the price caps are so great that the Commission should make return-based adjustments to the caps only if it is indisputable that the caps have strayed outside the zone of reasonableness – a showing that has not remotely been made here.[105] As explained above, the Commission's top priority should be maximizing the incentives for continued investment in the next-generation broadband networks of the future. If the Commission intervenes and pushes price capped rates too low, the result would be to create severe disincentives to continue those investments – an error that would be especially costly considering that the areas (*e.g.*, more rural) that are most in need of competitive investment remain subject to price caps. On the other hand, there is little potential benefit to intrusive Commission intervention, because many, if not most, price capped areas already are very competitive and CLEC and intermodal providers are increasing their investments in alternative

[103] *See, e.g.*, Verizon at 4-9; Qwest at 3; Comments of Hance Haney, WC Docket No. 05-25, RM-10593, 1-6 (Jan. 19, 2010) ("Haney"); AT&T at 49-73.

[104] *See, e.g.*, Verizon at 43-44; Qwest at 48-50; Haney at 5-6; AT&T at 50-55.

[105] *See, e.g.*, Qwest at 48-50; Haney at 5-6; AT&T at 49.

facilities in those areas, even in the more remote corners that historically have seen less competition. That increasing competition is more likely to provide an effective check on ILEC prices in the coming years than inherently imperfect Commission attempts at rate regulation.

A. The Commission's Analytical Framework For Assessing Price Cap Rates Cannot Be Based On "Profits."

Although most regulation proponents propose "profits" as the analytical framework for assessing price capped special access DSn rates, none of these commenters addresses the numerous fatal flaws in such an approach. First, as the economists who have submitted testimony in this proceeding explain, rates of return, or "profits," are an inappropriate analytical framework for determining the reasonableness of rates for individual services within a price cap system.[106] Under traditional, rate-of-return, rate-base regulation, the Commission used rates of return to measure the overall reasonableness of the *entirety* of a carrier's company-wide interstate rates and revenues. By contrast, the price cap system severs rates from costs and profits, because the whole purpose of a price cap system is to create incentives for ILECs to invest and to become more efficient by enabling ILECs to earn higher profits when they do so.[107] The price cap system's incentives can function only if ILECs can be sure that any efficiencies they achieve "will *not* come back to haunt them" by a future Commission decision ordering rate reductions based on determinations that the ILECs' returns are too high.[108] Accordingly, it would be arbitrary, capricious, and otherwise unlawful if the Commission were suddenly to find

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[106] *See, e.g.*, Topper Decl. ¶¶ 77-83; Qwest, attached Declaration of Timothy J. Tardiff and Dennis L. Weisman, ¶¶ 22-37 ("Tardiff-Weismann Decl."); Carlton-Sider Decl. ¶¶ 38-42; Carlton-Shampine-Sider Reply Decl. ¶¶ 31-32.

[107] *See, e.g.*, Qwest at 48-49; AT&T at 49-55 & Carlton-Sider Decl. ¶ 65.

[108] *USTA* v. *FCC*, 188 F.3d 521, 530 (D.C. Cir. 1999).

rates unreasonable – and reinitialize the caps – based solely on a determination that estimated "profits" are "excessive" under some standard.

Even if "profits" were relevant, *accounting* profits are meaningless. The overwhelming economic literature, as well as the testimony submitted in this proceeding, confirm that accounting returns provide no useful information for assessing whether rates are constrained by competition or otherwise set at reasonable levels. What matters is *economic* profits, and accounting returns are not valid proxies for economic profits and therefore say nothing about possible market power.[109] As the Commission itself explained earlier in this proceeding, "[h]igh or increasing rates of return calculated using regulatory cost assignments for special access services do not in themselves indicate the exercise of monopoly power."[110] Accounting measures of profits can be especially misleading because of various conventions used in the calculation of such returns. For example, as Professors Weisman and Tardiff illustrate, the straight-line depreciation methods used to compute accounting returns will *by definition* produce very high accounting returns – in excess of 100 percent – when assets have been in place for

[109] *See, e.g.*, Topper Decl. ¶¶ 77-79; Tardiff-Weisman Decl. ¶ 22, 24; Carlton-Sider Decl. ¶¶ 77-78; Carlton-Shampine-Sider Reply Decl. ¶ 32. *See also, e.g.*, Roger LeRoy Miller & Raymond P.H. Fisher, *Microeconomics, Price Theory In Practice*, at 386 (1996) ("it is economic profits, not accounting profits, that matter"); Franklin M. Fisher & John J. McGowan, *Firm Interdependence in Oligopolistic Markets*, 73 Am. Econ. Rev. 82, 82 (1983) ("the *economic* rate of return is the only correct measure of profit rate for purposes of economic analysis") (emphasis added); Maddala & Miller, *Microeconomics, Theory And Applications*, at 292 (1989) ("A zero economic profit for all firms does not imply that *accounting profit* will be 0 or even equal for all firms"); *see also Special Access NPRM*, ¶ 61 (2005) ("The aim of price cap regulation is rates that approximate those that a competitive firm would charge, and a competitive firm makes decisions based on economic, not accounting rates of return").

[110] *Id.* ¶ 129; *cf. also* Report & Order, *Petition of the People of the State of Cal. & the Pub. Utils. Comm'n of the State of Cal. To Retain Regulatory Authority over Intrastate Cellular Service Rates*, 10 FCC Rcd. 7486, ¶ 137 (1995) ("most carriers experienced a point when their accounting rate of return might be viewed as high yet, as a financial investment, their operations yielded no return because most or all of that return was reinvested to support expansion [and] [e]ven in the largest markets, in certain years increases in net plant were substantially above after-tax operating profits").

more than half their assumed depreciation lives, as is obviously the case with much of the telecommunications plant used to provide special access services.[111]

Moreover, any attempt to determine returns for *individual services* would require allocations among joint and common costs that would be inherently arbitrary.[112] Indeed, as AT&T and others have explained, the inherent arbitrariness of such an exercise would be infinitely greater today because of the complex nature of modern multi-service broadband networks. Moreover, ARMIS data certainly were never designed to set service-specific rates (and ARMIS does not even contain the sort of product specific detail that would permit the Commission to isolate "returns" for DSn-level service). Under ARMIS, costs are separated between the interstate and intrastate jurisdictions and are allocated among categories relating to specific services. As the Commission has explained, category-specific returns reported in ARMIS "do not serve a ratemaking purpose."[113] The category-specific cost data reported in ARMIS represent allocations of shared and common costs of a multi-service network across specific services,[114] and "economic theory does not provide a clear answer to the question of how joint and common and fixed costs should be allocated for costing purposes" and "[t]his is

[111] Tardiff-Weisman Decl. ¶ 24.

[112] *See, e.g.*, Hilyer- Makarewicz Decl. ¶¶ 8-12; Hilyer Reply Decl. ¶ 3-4; Carlton-Sider Decl. ¶¶ 75-76; Carlton-Shampine-Sider Reply Decl. ¶ 32.

[113] Order on Reconsideration, *Policy & Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd. 2637, ¶ 199 (1991); *see also* Second Report & Order, *Policy Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, ¶ 380 ("the collection of rate of return data on an access category or rate element level is improper and unnecessary for price cap LECs").

[114] Hilyer-Makarewicz Decl. ¶ 8; Tardiff-Weisman Decl. ¶¶ 23; Topper Decl. ¶¶ 81; Carlton-Sider Decl. ¶ 75-76.

particularly problematic in the telecommunications industry due to the very high proportion of joint and common costs and fixed costs."[115]

But ARMIS would be useless in any event, for numerous reasons.[116] ARMIS-based returns rest on allocations of ILEC network expenses and investment among jurisdictional categories as they existed in traditional circuit-switched networks, and the Commission recognized these allocations were obsolete as early as 1997.[117] Rather than mount a major effort to "correct" these allocations, the Commission instead froze them in 2001 – largely because ARMIS data at that point were no longer being used for any ratemaking purpose.[118] The separations freeze relieved ILECs of the burden of tracking and assigning expenses among these accounting categories, which meant that the percentage relationships of network and other costs that were assigned to the jurisdictional categories and then to special access were frozen at 2000

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[115] *See also* Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd. 16978, ¶ 157 n.515 (2003); *see also* First Report and Order, *Implementation of the Local Competition Provisions in the Telecomms. Act of 1996*, 11 FCC Rcd. 15499, ¶ 678 (1996) ("*Local Competition Order*") (it is "difficult for regulators to determine an economically-optimal allocation of any such joint and common costs"). *See also* Tardiff-Weisman Decl. ¶¶ 23; Topper Decl. ¶¶ 81; Carlton-Sider Decl. ¶ 75-76.

[116] *See, e.g.*, Topper Decl. ¶¶ 77-83; Tardiff-Weisman Decl. ¶¶ 22-42; Carlton-Sider Decl. ¶¶ 73-78; Hilyer-Makarewicz Decl. ¶¶ 4-36.

[117] *See, e.g.*, Hilyer-Makarewicz Decl. ¶ 12 (explaining and pointing out that, in 1997, "the FCC acknowledged that its cost allocation rules were outdated, finding that it would be necessary to undertake a "comprehensive review" of those rules, given that the telephone network had "changed substantially since the jurisdictional separations rules were first established in 1947" and that "[t]he introduction of new network control technologies changes the way services are delivered and thus call into question the validity of the service distinctions specified in the separations rules.") (quoting Notice of Proposed Rulemaking, *Jurisdictional Separations and Referral to the Federal-State Joint Board*, 12 FCC Rcd. 22120, ¶¶ 12-13 (1997)).

[118] In fact, the Commission exercised its forbearance authority in 2008 and determined that its cost assignment rules no longer served any legitimate regulatory purpose and eliminated the requirement that annual filings be made under these rules altogether. Order, *Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's ARMIS Reporting Requirements*, 23 FCC Rcd. 7302 (2008) ("*2008 Cost Assignment Forbearance Order*").

levels through 2007. However, during this period, special access lines and revenues increased dramatically (by 135.2% and 65.8%, respectively for AT&T) and switched access lines and revenues dropped (by 30.5% and 28.4%, respectively for AT&T) – and therefore, absent the freeze, there would have been equally dramatic shifts in the allocation of investments and expenses towards special access and away from switched access.[119] But because of the freeze, special access expenses in ARMIS stayed essentially flat (they increased from 6.1% in 2001 to 6.9% in 2007).[120] For this reason alone, the 2001 freeze itself caused the purported special access "rate of return" to jump by an order of magnitude.[121]

The Commission cannot go back now, however, and undo all of these errors.[122] Because of the freeze, the ILECs did not employ the systems or collect the data required to make cost allocations over the period between 2001 to 2007, and it would be grossly impractical now to try to recreate the data that would have been collected and reported if ARMIS had been kept current.[123] At the same time, as shown by NRRI and the ILEC declarants, even making some high-level adjustments to ARMIS – *e.g.* to increase investment and expenses allocated to special access to reflect relative increases in special access revenues from 2000 through 2007 – confirms that special "returns" were far lower than the unadjusted ARMIS data indicates.[124]

In short, there is simply no basis for using ARMIS-derived returns in this proceeding, nor are there any "adjustments" that could be made to salvage ARMIS for purposes of this inquiry. Despite the Commission's explicit request to address the shortcomings with using ARMIS data,

[119] Hilyer-Makarewicz Decl. ¶¶ 16-17.

[120] *Id.* ¶ 17.

[121] *Id.* ¶¶ 27-32.

[122] *Id.* ¶¶ 20-26.

[123] *Id.*

[124] *Id.* ¶¶ 27-32.

most of the re-regulation proponents mindlessly cite ARMIS returns without even acknowledging the issues the Commission has raised. The only commenter who purports to defend the use of the historic ARMIS-derived returns is Ad Hoc, which submits "A Defense Of ARMIS" prepared by its consultants, Economics and Technology Inc. ("ETI").[125] But ETI's "Defense of ARMIS" rests both on a series of assertions that the Commission has rejected in the past and on a number of other misunderstandings and mistakes.

Indeed, the entire premise of the ETI paper is so implausible that the declaration cannot be taken seriously. ETI does not grapple with the fact that ARMIS data were never designed to set service-specific rates, nor does it deal with the fact that the Commission expressly found that the cost allocation rules used for ARMIS reporting had become outdated by 2001[126] - it deals only with the argument that the separations freeze dramatically increased the inaccuracies after 2001. ETI's answer is to insist the ARMIS-derived special access "returns" from 2001 and 2007 were perfectly accurate – *despite* the fact that the Commission's freeze caused the "assigned" special access expenses and investment to be held flat while special access lines and revenues increased dramatically. In other words, ETI is literally saying that ARMIS returns were accurate before 2001 but suddenly would have become inaccurate starting in 2001 but for the freeze, which – miracles of miracles – allowed service-specific returns to remain accurate from 2001 to

[125] *See* Ad Hoc, Attachment B (ETI Paper).

[126] ETI contends that if the Commission thought the separations and cost allocation factors were meaningless, it would instead have eliminated the ARMIS reports altogether rather than merely freezing the factors. *ETI* at iv. This contention is baseless for three reasons. First, the issue whether to eliminate ARMIS reporting for price cap carriers was not before the Commission in 2001. Second, it made sense not to eliminate the cost assignment reports because the Commission's plan in 2001 was to adopt updated assignment rules and continue the reports. Third, in all events, the Commission has found that because "interstate rates are now generally regulated under price caps, we agree with AT&T that the Cost Assignment Rules are unnecessary in determining whether its rates are just, reasonable, and not unjustly or unreasonably discriminatory." *2008 Cost Assignment Forbearance Order*, ¶ 16.

2007! This claim is preposterous and goes far beyond even what the most unhinged re-regulation proponent is willing to claim on ARMIS's behalf.

ETI argues that, well, special access costs *did* increase in ARMIS after 2001 – by operation of certain aspects of the ARMIS rules, the percentage of the ILECs' expenses and investment that was assigned to special access in ARMIS increased slightly (by 1-2%) between 2001 and 2007 (with the assigned special access percentage of total investment increasing from 9% to 10% during this period).[127] But it is implausible in the extreme to suggest that a mere 1-2% increase in special access's assigned percentage of expense and investment would appropriately capture the huge divergence in switched and special access during this period, in which AT&T's special access lines and revenues *increased* by 135 percent and 65 percent, respectively, and in which its switched access lines and revenues *decreased* by 30% and 28.4%, respectively.[128]

ETI cannot even square its arguments with simple arithmetic. It argues that due to economies of scale, the special access percentage of investment and expenses will not necessarily increase in precise proportion to the very large increases in special access lines that occurred from 2000 to 2007. But it concedes that switched access costs *do* change in proportion to changes in lines. Given that the number of AT&T's switched access lines decreased by 30.5 percent from 2000 to 2007, according to ETI's logic AT&T's switched access costs should have fallen by 30.5 percent. That fact by itself means that the portion of overall investment and

[127] This slight increase occurred because the separations freeze froze only the percentage allocations, not the absolute amount of investment in each category. Because there was increased investment in equipment that can be used to provide both special and switched access (*e.g.* interoffice fiber, feeder fiber, and circuit equipment) and because there was reduced investment in equipment used only to provide switched access (*e.g.* switches), there were slight increases in the overall percentages of total interstate expenses and investment assigned to special access under ARMIS, even during the period of the freeze. Hilyer Reply Decl. ¶¶ 7-9.

[128] Hilyer Reply Decl. ¶¶ 5-6.

expenses attributed to special access should have increased by substantially more than the one or two percentage points reflected in ARMIS.[129]

ETI is even challenging the 2009 NRRI Report's conclusion that this mismatch results in ARMIS-derived returns that are overstated by an order of magnitude.[130] ETI disputes that NRRI's analysis is meaningful because "all of the investments were [not] made in the year being analyzed."[131] This is nonsense: the rate of return on which ETI seeks to rely is based on the total investment, expenses, and revenues for any given year. If ETI is saying that there is a mismatch in investment, expenses and revenues in any given year, then ETI is conceding that its ARMIS-derived profit calculations are misleading as well as they are based on the same total investment, expenses and revenues in any given year.[132]

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[129] *Id.* ¶ 10.

[130] ETI Paper at n. 23.

[131] *Id* at 14.

[132] *See* Hilyer Reply Decl. ¶¶ 11-12. In this regard, ETI's study includes a Table 2.2 that purports to show that "16% of the total new plant put in service [from 2001 through 2007] was allocated to the special access category – substantially more than the historic special access of total plant in service (8.5%), and quite close to the special access revenue ratio of 18%, referenced above." Everything about this statement is inaccurate. First, the fact that 16% of total new plant in service was allocated to special access under ARMIS is meaningless by itself without knowing what the increase should have been, and the fact that special access lines increased by 135.2% percent and special access revenues increased by 65.8%, while switched access lines and revenues plummeted, strongly suggests that far more than 16% of total new plant in service was actually used in the provisioning of special access services. *See* Hilyer Reply Decl. ¶ 13. Second, ETI compares apples to oranges when it compares the portion of the change in total plant in service attributed to special access (16 percent) to the *total* embedded portion of total plant in service attributed to special access (8.5%). *See id.* Third, ETI misleadingly suggests that the 16 percent special access investment ratio is close to the 18 percent special access revenue ratio. The 18 percent special access ratio is the ratio of special access investment to *total* plant investment that would have been achieved in 2007 if special access investment was adjusted to track the changes in special access revenues. *Id.* The comparable figure in ETI's Table 2.2 is the 10 percent ratio of total special access plant in service to total plant in service for 2007 produced in ARMIS by the application of the frozen separation rules. *Id.*

ETI's contention that AT&T's ARMIS-derived special access returns are too low because the investments used in the calculations include "expenditures on U-Verse . . . of roughly $2 billion annually" is also incorrect.[133] As explained in the attached declaration of Mr. Hilyer, AT&T's U-verse service was treated as a non-regulated service in accordance with its Cost Allocation Manual (CAM) filed with the Commission.[134] As such, the AT&T telecommunications affiliates' U-verse related revenues, expenses and investment (a significant portion of AT&T's U-Verse investments were made by AT&T affiliates whose costs are not reported in ARMIS) were treated in ARMIS as non-regulated in accordance with the methodologies described in the CAM., and thus are not reflected in AT&T's *regulated* special access ARMIS cost data.[135]

Finally, ETI argues that ARMIS-derived special access returns must be accurate because otherwise ILECs would have submitted their own cost and revenue data demonstrating that their special access returns are lower. This too is baseless. For the reasons explained above, any

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ETI's additional claim that ARMIS-derived returns are reasonable because special access "net plant" has decreased at a lower rate than other services is also fundamentally flawed. First, as several experts have shown in this proceeding, the fact that ARMIS data show any decreases in special access plant is reason enough to confirm that it is fatally flawed, since all other available marketplace data confirms that the economic value of special access investment increased significantly since 2001. Hilyer-Makarewicz Decl. ¶ 19. In any event, as demonstrated in the attached declaration of Ron Hilyer (¶¶ 14-17), ETI relies on flawed and mismatched data, and it is not even true that ARMIS data shows special access net plant decreasing substantially faster than other plant.

[133] ETI Paper, at 24.

[134] Hilyer Reply Decl. ¶ 18, attached hereto as Exhibit B.

[135] *Id.* ETI's non-data arguments are also clearly without merit. ETI argues, for example, that ARMIS-derived returns are accurate because AT&T has relied on ARMIS data in other proceedings. In fact, AT&T's witness stated that "ARMIS is no better or worse than any cost accounting system for a large, multiproduct firm," (ETI at 18) which is hardly a ringing endorsement of ARMIS. ETI also points out that this same witness used ARMIS to compare AT&T's book costs to UNE prices, but the witness used ARMIS 2001 data – *i.e.*, pre-freeze data – and made many adjustments to the ARMIS data. In all events, these analyses did not compute ARMIS returns, nor did they endorse ARMIS as a valid measure of economic costs.

attempt to allocate the myriad shared and common investments and expenses to special access would be completely arbitrary. Prior to the 2001 freeze, AT&T had to devote enormous resources to the feckless task of trying to allocate joint and common cost among its services (notwithstanding the fact that it was price cap regulated for a decade and these calculations served no ratemaking purpose), but the 2001 ARMIS freeze put an end to that exercise, and the Commission eliminated cost assignment reporting requirements in 2008. No possible inference can be drawn from the fact that AT&T and other LECs have not attempted to devise internal methods of replicating pointless functions that the Commission was unable or unwilling itself to prescribe.[136]

B. Rate Comparisons Are Also An Inappropriate Framework For Assessing Price Cap Rates.

Other commenters claim that the Commission can assess price capped rates based on various types of rate comparisons. All of the suggested comparisons, however, would be either inappropriate or unworkable.

For example, re-regulation proponents press the same apples-to-oranges rate comparisons that AT&T and others have repeatedly refuted (and that are refuted again in Appendix A, attached hereto and by Professor Carlton in his Reply Declaration, attached hereto). They suggest that if price caps are higher than state-determined UNE rates, then the caps are unreasonable – even though the Commission has previously expressly rejected reinitializing the caps at TELRIC and has found TELRIC prices to be flawed in numerous respects.[137] They suggest that pricing flexibility rates are unreasonable if they are higher than price cap rates, even

[136] *See also* Hilyer Reply Decl. ¶ 20.

[137] First Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing End Common Line Charges*, 12 FCC Rcd. 15982, ¶¶ 289-90, 294-95 (1997) ("*Access Charge Reform Order*"). *See also* Appendix A, attached hereto, at 4-6.

though the Commission has repeatedly recognized that price cap rates may be set artificially low and "has explicitly recognized that Phase II pricing relief could lead to price increases for customers in some areas."[138]

They assert that enterprise class DS1 rates with high service level guarantees and other high-end features are excessive because they are higher than "best efforts" residential-grade DSL and cable modem services, and ignore that comparable enterprise class DSL service is, in fact, priced similarly to DS1 service.[139] They assert that U.S. DSn prices are higher than those charged by British Telecom ("BT") for services in the United Kingdom, but base the comparison on a BT circuit with only one channel termination and a U.S. circuit with *two* terminations, fail to account for the discounts available to U.S. customers, fail to apply a proper exchange rate to convert pounds to dollars, and omit the fact that the prices AT&T actually charges BT for special access in the U.S. are lower than what BT charges AT&T for special access in the U.K.[140] They assert that ILEC prices exceed CLEC prices, but fail to provide anything but admitted apples-to-oranges comparisons and fail to account for the fact that CLECs do not have the same carrier of last resort and other service obligations that cause them to have higher costs than CLECs.[141] They also assert that ILEC prices are higher than regulated NECA prices, but fail to account for ILEC discounts and rely on the prices charged by only 8 of the more than 1100 NECA carriers, and omit the fact that a comparison of the highest *undiscounted* ILEC prices are mostly *lower* than that of the vast majority of NECA carriers.[142]

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[138] GAO Report, Appendix III: Comments of the Federal Communications Commission, at 2 (citing *Pricing Flexibility Order*, ¶ 155). *See also* Appendix A, attached hereto, at 2-4.

[139] *See* Appendix A, attached hereto, at 6-8.

[140] *See id.* at 8-9.

[141] *See id.* at 9-10.

[142] *See id.* at 11-12.

By contrast, Qwest proposes that the Commission collect comprehensive competitive data for a sample Phase II MSAs, use that data to identify Phase II MSAs that are subject to sufficient competition, and then use the rates in those competitive Phase II areas as a "benchmark" for assessing rates in price cap areas.[143] According to Qwest if rates in price cap MSAs are near or below those in the competitive benchmark Phase II MSAs, then the rates in the price cap MSA can be presumed to be just and reasonable because, according to Qwest, price cap markets generally have higher costs.[144] On the other hand, if the rates in the relevant price cap markets "are higher than the benchmark rates in competitive Phase II markets, further investigation may be warranted to explain the discrepancy."[145]

Qwest's proposal has more theoretical appeal, but it would be difficult to implement in practice. Indeed, any attempt to compute special access rates for any particular MSA for purposes of geographic comparisons would run into a variety of complications. For example, any proper comparison between prices in two areas of the country must account for differences in costs and demand conditions in the two areas and the possibility that arbitrary regulatory reductions have forced price cap rates below competitive levels. In addition, many customers purchase special access services under a single contract that may extend across multiple geographic areas and/or multiple services. Moreover, just because a rate in one area is higher than in another area would not by itself justify additional regulation; because of the inherent

[143] Qwest correctly points out that the reverse benchmark comparison – using price cap rates to assess pricing flexibility rates – would be invalid because, among other reasons, as the Commission has recognized, price cap rates may be set artificially below competitive levels. *See* Qwest at 41, n.96; *see also* Appendix A, attached hereto, at 2-4.

[144] Qwest at 41.

[145] *Id.*

uncertainty and error in such an exercise, regulatory intervention would be unwarranted unless the higher rate fell well outside a reasonable "buffer zone."[146]

In short, the Commission should not intervene in the price cap system unless it could be shown that such a fundamental breakdown had occurred that price cap LECs' rates had drifted indisputably outside the zone of reasonableness. No party has come close to making that sort of showing, nor would any of the rate comparisons proposed call the current rates into question. The vast majority of Phase I areas are as competitive as Phase II areas. Indeed, most channel termination services are provided in Phase I areas, even though those services are concentrated in densely populated downtown areas, such as Chicago, Los Angeles, and Houston, where the record shows there are already myriad intra- and inter-modal providers fiercely competing against ILEC special access services. Given that the ILECs' price capped services almost always compete with multiple facilities-based competitive offerings, the Commission is far more likely to make a mistake if it intervenes in the price cap system to try to dictate the "correct" prices.[147] The potential error costs are enormous – because artificially low rates will discourage broadband investment in price capped areas where it is most needed – while expanding competitive entry and investment from intra- and intermodal providers is much more likely in the coming years to be an effective discipline on ILEC rates without compromising the Commission's broadband goals.

C. The Comments Confirm That There Is No Basis For Developing And Adopting A New Productivity Factor.

The comments also confirm that the Commission's analytical framework should not include any revisiting of the X-Factor. Re-regulation proponents have largely abandoned earlier

[146] *See* Carlton-Sider-Shampine Reply Decl. ¶¶ 37-39.

[147] *See id.* ¶¶ 39, 50.

proposals to adopt a new, higher productivity factor and reinitialize the caps by applying it *retroactively,*[148] but a few commenters still argue that the Commission should apply a higher X-Factor prospectively.[149] The Commission should reject this proposal as well, because all relevant evidence indicates that the current X-Factor is reasonable, thus making it unnecessary for the Commission to undertake the enormously expensive and time-consuming task of trying to develop a more "accurate" one, guaranteeing years of uncertainty that could only reduce incentives to invest in and expand broadband networks.

The purpose of the X-Factor is to ensure that efficiencies obtained by ILECs under price caps are shared with customers through lower rates while at the same time ensuring that prices are not forced so low as to deter ILEC network investment and preclude competitive entry. No commenter has submitted any valid evidence that the current X-Factor – which is set equal to the rate of inflation (GDP-PI) – is set at an inappropriate level or is not serving its intended purpose. To the contrary, the record confirms that the X-Factor has contributed to significant reductions in special access prices (by forcing reductions in real terms), while at the same time retaining ILEC incentives to invest billions of dollars in their networks and attracting extraordinary levels of entry and expansion by intra- and inter-modal competitors.

Indeed, the economic testimony submitted in this proceeding confirms that, if anything, the current X-Factor is set too high. As demonstrated by Embarq's economist, data from the Bureau of Labor Statistics show that the overall productivity for Wired Telecommunications was *lower* than various measures of productivity of the economy as a whole, which could potentially

[148] Only Paetec (at 76, n.260) proposes to retrospectively apply a new productivity factor. For the reasons stated above (and in AT&T's comments at 72-73), any such retrospective application of a productivity factor would be unlawful.

[149] *See, e.g.,* Sprint-Nextel at 46.

justify a productivity factor lower than the rate of inflation.[150] Moreover, as Professor Carlton explains, there have been many changes in the telecommunications industry over the past several years that would suggest a lower X-Factor. For example, productivity gains associated with the transition from rate-of-return regulation to price caps would be exhausted.[151] Other changes that would put downward pressure on the X-Factor include changes in input prices (*e.g.*, copper and labor), the maturity of legacy copper-based DSn services relative to other technologies, and the

[150] Stair Decl., at 9-10. Paetec also supports reinitializing price caps using a measure of forward-looking costs. But Paetec offers no non-arbitrary or workable approach to computing accurate forward-looking costs for special access services. As AT&T and others have demonstrated, such an approach would be extremely burdensome, would undermine investment by creating years of uncertainty and the potential for error, and is ultimately unnecessary absent a clear breakdown with the existing price caps and there is no evidence of such a breakdown. *See, e.g.*, AT&T at 72-74; Qwest at 46, n.105. Paetec's additional proposal (at 77) that the Commission re-institute revenue sharing is likewise a non-starter. As the Commission recognized in 1997 when it eliminated this "major vestige of rate-of-return regulation," it "severely blunts the efficiency incentives of price cap regulation" and "reduce[s] the benefits of price caps to consumers." *Price Cap Performance Review for Local Exchange Carriers*, 12 FCC Rcd. 16642, ¶ 147 (1997) ("*1997 X-Factor Order*"); *LEC Price Cap Performance Review*, 10 FCC Rcd. 8961, ¶¶ 187-89, 197 (1995) (concluding as early as 1995 that sharing blunted efficiency incentives and should eventually be eliminated). Moreover, there is no evidence that a sharing mechanism is appropriate. The Commission's sharing mechanisms applied to overall ILEC earnings (and Paetec does not propose a different mechanism here), and the record shows that ILEC overall earnings are quite modest. Hilyer-Makarewicz Decl. ¶ 33. Finally, Paetec's proposal that the Commission modify the current basket and category structure should be rejected for the reasons set forth in AT&T's 2007 Reply Comments, at 68. In short, this proposal would improperly put the Commission in the position of micromanaging almost every special access rate element. Even at the beginning of the price cap regime, when special access services were far less competitive than they are today, the Commission saw no need to subdivide individual special access rate elements into separate baskets. Rather, the Commission concluded that "a carrier's ability to adjust prices constitutes one of the major benefits of incentive regulation." Report And Order And Second Further Notice Of Proposed Rulemaking, *Policy and Rules Concerning Rates for Dominant Carriers*, 4 FCC Rcd. 2873, 2924 (1989). The Commission "chose a middle course, dividing LEC services into four product 'baskets,'" a scheme that was upheld by the D.C. Circuit. *See Nat'l Rural Telecom Association* v. *FCC*, 988 F.2d 174, 181-83 (D.C. Cir. 1993). The current special access basket was established in the *CALLS Order*, and no party appealed that decision (even though the Commission had already adopted the *Pricing Flexibility Order*). In today's highly competitive environment, there is plainly no need to take the unprecedented step of establishing rate-element-specific baskets within the special access basket.

[151] Carlton-Shampine-Sider Reply Decl. ¶¶ 73-74.

overall decline of existing wireline businesses.[152] Proponents of a new X-Factor completely ignore these controlling facts, and instead rely on their spurious claims that prices are too high based on meaningless ARMIS-derived returns and invalid benchmarks. Given the total absence of evidence that the current X-Factor is too low, there is no reason for the Commission to undertake the inevitably long and very costly task of trying to develop a new, more "accurate" X-Factor.

There is no question that any attempt to develop a new X-Factor would be enormously burdensome for both the Commission and the parties. If history is any guide, such a proceeding would take years (and require perhaps multiple appeals) before any final special-access-specific X-Factor could be established. During the 1990s, the Commission devoted the better part of a decade trying to establish a much simpler company-wide productivity factor, and still the Commission was unable to establish a permanent one that withstood judicial review. The Commission has never attempted to design (or offer a theoretical justification for) a service-specific productivity factor, which would be considerably more difficult than computing a company-wide productivity factor. As an Embarq economist has explained in this proceeding:

> Given the impossibility of accurately measuring a single-product productivity in the case of a multi-product firm with a non-separable production function, any attempt to calculate such a number would quickly devolve into guesswork. This is because any such calculation would require that year-over-year changes to shared, joint, and common inputs be allocated among different services, and any such allocation would by definition be arbitrary. In fact, the Commission in the past has expressed concern regarding the creation of a productivity factor unique to a single service because of the arbitrary nature of such a calculation.[153]

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[152] *Id.*

[153] Stair Decl., at 6-7 (attached to Comments of Embarq, WC Docket No. 05-25 (Aug. 8, 2007), *citing* Fourth Further Notice of Proposed Rulemaking, *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd. 13659, ¶ 69 (1995).

Moreover, starting down the path of developing a new X-Factor would result in years of uncertainty for ILECs, special access competitors, and customers, which could only undermine the Commission's goal of creating an environment that encourages investment, entry and expansion by carriers.[154] In this regard, Professor Carlton further emphasizes that the Commission must be cognizant of the asymmetry in the potential harm from setting regulated prices "too high" or "too low" also pertain to the choice of the X-Factor.[155] The costs of setting prices "too low" (deterring investment by LECs and rivals) are likely to be greater than setting them "too high," since prices that are "too high" will attract entry that can help reduce prices.[156]

IV. THE DISCOUNT PLANS OF THE PRICE CAP LECs FOSTER COMPETITION AND BENEFIT CONSUMERS.

The comments and economic declarations establish that there is no possible basis for adopting a blanket ban on any of the price cap LECs' discount plans as anticompetitive or unreasonable in this rulemaking proceeding.[157] These plans are no different than agreements that are commonplace in markets that are unquestionably competitive,[158] and they are no different

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[154] Sixth Report And Order, *Access Charge Reform,* 15 FCC Rcd. 12962, ¶ 174 (2000) ("*CALLS Order*") ("controversy regarding the current status of the X-Factor and the concurrent uncertainty over the resolution of the controversy disrupts business expectations and future investment decisions of both LECs and new entrants").

[155] Carlton- Shampine-Sider Reply Decl. ¶¶ 73-74.

[156] *Id.*

[157] Topper Decl., ¶¶ 62 ("economic analysis suggests that the volume and term discounts and other provisions contained in some ILEC special access discount plans and contract tariffs are mutually beneficial, reflect an attempt by incumbent providers to differentiate their service offerings in response to customer demand and competitive pressure, and can enhance economic efficiency by reducing the costs of customer churn"); AT&T, at 74-82 & Carlton-Sider Decl., ¶¶ 87-99; Carlton-Shampine-Sider Reply Decl. ¶¶ 75-83.

[158] Topper Decl. ¶ 66 ("The claim that discounts based on volume, term, and annual expenditure commitments are anticompetitive is difficult to square with the fact that such discounts are common practice in a number of industries that display vigorous competition, which suggests that such agreements are not generally harmful" and providing examples); AT&T, at 77-80 & Carlton-Sider Decl. ¶ 90; Carlton-Shampine-Sider Reply Decl. ¶ 75.

than the agreements that CLECs themselves form with their own special access customers.[159] Customers who subscribe to these plans are large sophisticated purchasers of telecommunications services who *negotiated* or otherwise voluntarily made particular commitments following intense competitive bidding in which CLECs and others have made competing offers for all or some of the customer's business.[160] These terms and conditions clearly benefit both buyers and sellers, the commitments apply only during the term of a contract, and each customer's business is up for the grabs at the contract's end.[161] Most fundamentally, however, the fact that CLECs, cable companies and microwave wireless providers have invested billions of dollars in developing and expanding their networks during the ten-year period in which ILECs have been offering these volume and term discounts, definitively refutes any claim that ILEC discount plans have operated as a substantial entry barrier or have "locked in" customers and precluded them from purchasing services from competitive carriers.[162]

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[159] *See* AT&T, at 81.

[160] Topper Decl. ¶¶ 67, 68 ("[M]any purchasers of high-capacity services are large, sophisticated buyers who spend hundreds of millions of dollars annually on telecommunications services. They exert their substantial bargaining power by obtaining multiple bids from competing suppliers, switching providers to obtain lower prices and better non-price terms, and using the service of systems integrators." "Economists generally find that the voluntary mutually beneficial nature of such agreements makes the prospect of competitive harm unlikely. Customers are not forced to accept the terms of a discount plan or contract tariff; customers and suppliers alike enter these agreements voluntarily, hence both parties benefit"); AT&T, at 80-82.

[161] Topper Decl. ¶ 67 (In addition to the obvious benefit of reduced prices, buyers reduce their transaction costs and may receive specialized or customers services or contract terms in return for [these commitments]. . . . Volume and term commitments and termination liabilities are beneficial to suppliers as well. Term commitments reduce the volatility of a supplier's revenue stream and reduce the risks and inefficiencies associated with customer churn, including higher operating capital costs, while termination liabilities provide suppliers with a means of recovering investment in order to provide service."); AT&T, at 80-82; Carlton Sider Decl. ¶ 89, 93-94.

[162] AT&T at 81-82; Carlton-Sider Decl. ¶ 92.

Accordingly, there is no basis for declaring in a rulemaking that the terms and conditions offered in the ILEC discount plans are *per se* unlawful; because of their obvious consumer benefits and pro-competitive features, there is no basis for categorically prohibiting them.[163] In the unlikely event a CLEC ever has a basis for claiming that an ILEC has engaged in predatory pricing or some other forms of exclusionary conduct through a particular discount plan, the remedy is to file a complaint under Section 208.[164] The specific terms and conditions about which some commenters complain here, however, clearly offer significant precompetitive benefits and should be encouraged, not eliminated.

1. Volume and Term Requirements. The declarations of the economists demonstrate that there is no basis for a blanket determination that volume and term plans are anticompetitive.[165] Even Sprint-Nextel's economist (Dr. Bridger Mitchell) acknowledges this basic point. He concedes that "in general, when the consumer is offered a lower price for purchasing a greater quantity of service – in quantity consumed per unit time, or length of time consumed - and chooses the larger quantity or term, his consumer surplus is increased."[166]

Dr. Mitchell, however, argues that competitors lack the scale to compete with such term and volume discounts.[167] This argument fails on multiple levels. First, it is refuted by

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[163] Topper Decl. ¶ 70 ("Given the existence of pro-competitive justifications for the use of volume and term discounts in special access contracts, an *ex-ante* regulatory policy that restricts discounting practices would impede beneficial competition and cause economic harm"); AT&T at 82; Carlton-Sider Decl. ¶ 95-99.

[164] Topper Decl. ¶¶ 62 ("allegations of anticompetitive conduct regarding business practices that have precompetitive justifications are best addressed by a focused *ex-post* analysis rather than by [an] *ex-ante* regulatory restriction that will impede beneficial competition"); AT&T at 92.

[165] Topper Decl. ¶¶ 62, 70; AT&T at 88-92; Carlton-Sider Decl. ¶¶ 87-99 & Carlton-Shampine-Sider Reply Decl. ¶¶ 78-79.

[166] Mitchell Decl. ¶ 116.

[167] Mitchell Decl. ¶¶ 119-20.

marketplace facts. Competitors have invested and continue to invest billions of dollars in competing intramodal and intermodal networks, which they obviously would not do if they believed they could not compete against the ILEC volume and term discount plans. Further, the record shows that competitors do indeed undercut ILEC prices and win ILEC customers.[168]

Second, Dr. Mitchell's argument assumes that the ILECs' alleged larger scale necessarily translates into lower costs. In fact, the ILECs' larger scale is attributable in part to their carrier of last resort and other service obligations that require ILECs' to serve very high cost customers. Competitors that operate on smaller scales – many of which purposely cherry pick the lowest cost customers – can have significant cost advantages over ILECs.

Third, to the extent competitors have smaller networks, Dr. Mitchell incorrectly assumes that that they cannot compete on the same scale as ILECs. In fact, competitors can fill any gaps in their network offerings with services provided using below-cost UNEs, special access, or services purchased from alternative special access providers.

Finally, and most fundamentally, to the extent that the ILECs have scale advantages over CLECs, these are legitimate, and it promotes competition, benefits consumers, and advances the public interest when ILECs reflect the efficiencies of their operations in the prices that they charge. Sprint-Nextel is illicitly asking the Commission to advance the interests of individual competitors at the expense of competition and the public interest.[169]

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[168] *See, e.g.*, Comments of SBC, *Special Access Rates For Price Cap Local Exchange Carriers*, WC Docket No. 05-25, Tab A, Declaration of Parley C. Casto, ¶¶ 59-75 (filed June 13, 2005); Supplemental Reply Comments of AT&T Inc., *Special Access Rates For Price Cap Local Exchange Carriers*, WC Docket No. 05-25, Supplemental Declaration of Parley C. Casto, ¶¶ 11-14 (filed Aug. 15, 2007).

[169] Order and Authorization, *In re Application of Alascom, Inc. AT&T Corporation and Pacific Telecom, Inc. For Transfer of Control of Alascom, Inc. from Pacific Telecom, Inc. to AT&T Corporation; and Application of Alascom, Inc. For Review of Authorization to Acquire and Operate a Fiber Optic Cable System between Alaska and Oregon for the Provision of Interstate*

2. Revenue Requirements. Some of the many discount plans offered by AT&T include discounts in return for the customer agreeing to spend a certain amount on AT&T special access services. Sprint and NoChokePoints allege that these discounts are not justified by any benefit for AT&T, and that these discounts serve only to force customers to commit their special access budgets to AT&T and to preclude competitors from competing for such revenues.[170] Sprint and NoChokePoints fail to provide any support for these allegations, nor could they.

First, these discount programs clearly serve a legitimate purpose. Like other special access providers, AT&T incurs very high recurring shared and common costs of operating its networks and meeting its carrier of last resort and other service obligations, and the guaranteed income stream from these types of arrangements significantly reduces AT&T's business risk and better enables AT&T to budget future network upgrades and expansions. The D.C. Circuit has expressly recognized this fact, explaining that prohibiting special access discount plans with a 90 percent revenue commitment would "frustrate[e] the Bell Operating Companies' attempts to maintain stable utilization rates on their networks or to lower their prices."[171] The Department of Justice has likewise explained that agreements in which "a buyer promises to purchase all its needs for an input from a specified seller" can produce significant benefits to both producers and

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Switched and Private Line Services, 11 FCC Rcd. 732, ¶ 56 (1995) (the "Commission's statutory responsibility is to protect competition, not competitors."); Report and Order, *Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd. 5880, ¶ 60 (speaking of the superior size, financial strength, and technological advantages of legacy AT&T when it was the sole dominant long-distance carrier and explaining that "[t]he issue is not whether AT&T has advantages, but, if so, why, and whether any such advantages are *so great as to preclude the effective functioning of a competitive market*.") (emphasis added); *id.* ("Indeed, the competitive process itself is largely about trying to develop one's own advantages, and all firms need not be equal in all respects for this process to work.").

[170] Sprint at 39; NoChokePoints at 29.

[171] *BellSouth* v. *FCC*, 469 F.3d 1052, 1056 (D.C. Cir. 2006).

consumers.[172] For example, they "allow suppliers to anticipate demand while providing customers with protection against shortages of needed inputs" and "competition among manufacturers to become the exclusive supplier to a retailer can result in significant savings for the ultimate consumer."[173]

Second, customers are not forced to enter into these discount programs. Indeed, the D.C. Circuit, in evaluating a special access discount program with a 90 percent special access revenue requirement, rejected the notion that customers are forced to enter into such arrangements, explaining that that when customers do so, it is the result of their "free choice."[174] Customers that enter into these programs have simply made the determination that they are better offerings than the other discount programs offered by the price cap LEC or by competitors.

Third, it is not true that these discount programs typically tie up so much customer revenue as to preclude competition. There has been significant entry and growth by competitors during the past several years. Revenue commitment plans typically are tied only to the amount of purchases the customer makes with the *ILEC*, and therefore do not tie up any services the customer spends on competitive facilities or on self-supply, nor do they tie up any increased future demand. Thus, even a 100 percent revenue requirement discount program would not prevent customers from purchasing from others, and that is especially true today in an environment where special access demand is exploding.

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[172] Competition and Monopoly, *Single-Firm Conduct Under Section 2 of the Sherman Act*, U.S. Department of Justice, at 139 (Sept. 2008), *available at* http://www.justice.gov/atr/public/reports/236681.pdf.

[173] *Id*. at 140. *See also* Carlton-Shampine-Sider Reply Decl. ¶ 79 ("Revenue and volume commitments, in the absence of demonstrable and significant consumer harm, generally benefit competition, not harm it").

[174] *BellSouth*, 469 at 1055-60.

Fourth, other, competitive providers of special access services (including Sprint before it spun off its wireline assets) have offered similar arrangements, with discounts that depend on a customer's willingness to make some form of revenue commitment.[175] Presumably, proponents of special access re-regulation would not suggest that these providers sought to use such arrangements to limit competition.

In all events, the revenue-based discount programs that AT&T typically negotiates have modest requirements. For example, AT&T recently negotiated a contract with one of the nation's largest competitive suppliers of wireline and wireless services that provides very significant discounts on special access purchases in return for the customer agreeing to continue purchasing from AT&T an amount of special access services that is at least 50 percent of the amount the customer spent on such services with AT&T in the prior period. Since this customer already makes very significant purchases from CLECs and wireless providers (and likely cable companies) and has announced that it expects to continue to significantly expand its network, this arrangements covers far less than 50 percent of this customer's total demand.

3. *Shortfall Penalties And Early Termination Penalties.* Discount programs are based on a simple *quid pro quo*. The customer agrees to certain terms, *e.g.*, to purchase a certain number of circuits or to spend a certain amount for an agreed upon time period, and in return the LEC charges highly discounted prices for the service. Because the LEC typically begins applying the discounts upon execution of the arrangement, no LEC would generally be willing to offer such discounts if it believed the customer would easily walk away from holding up its end of the bargain by choosing not to make the agreed upon purchases for the agreed upon period. The purpose of shortfall and early termination penalties is to provide the enforcement mechanism

[175] See Comments of SBC, Special Access Rates For Price Cap Local Exchange Carriers, WC Docket No. 05-25, Tab A, Declaration of Parley C. Casto, ¶ 73 (filed June 13, 2005).

necessary to ensure that customers hold up their end of the bargain and thus to provide the LECs with the necessary incentive to provide such discounts. As Dr. Mitchell concedes, "the application of shortfall penalties can be economically justifiable."[176]

Contrary to Sprint's assertions, AT&T's shortfall and termination penalties are quite reasonable. For example, Sprint's poster child for supposed unreasonable shortfall penalties is AT&T Southwest Tariff No. 73, Section 7.2.22(E). Here, Sprint's economist, Dr. Mitchell, is wrong when he asserts that AT&T charges $900 "[f]or each channel termination below the commitment level."[177] In fact, the customer pays $0 for shortfalls up to 20 percent below the commitment level. For example, a customer with a 1000 circuit commitment will not incur any shortfall penalties even if it has a 200 circuit shortfall. If the customer falls below this level, the customer is then charged a shortfall penalty of $900 for every circuit that exceeds 20 percent below the commitment level, resulting in very low per unit penalties. For instance, a customer that makes a 1000 circuit commitment, but purchases only 750 circuits, will still obtain the *full* discount on the 750 circuits it purchases, but it will be billed $900 for the 50 circuit shortfall in excess of 20 percent, for a total penalty of $45,000. Since the *actual* shortfall was 250 circuits (1000-750), the effective per circuit penalty is only $180.[178]

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[176] Mitchell Decl. ¶ 129. *See also* Carleton-Shampine-Sider Reply Decl. ¶ 80 ("Shortfall penalties and termination liabilities can serve an important economic role").

[177] Mitchell Decl., n.80.

[178] The tariff provides the following example: "Customer A has a [Commitment Level] CL = 1,000 Channel Terminations for the month of June. Customer A must have at least 800 DS1 Channel Terminations in-service to meet the 80% target. In July, the monthly review calculated 795 DS1 Channel Terminations in service for the month of June. The difference between 80% of the CL (800) and the actual in-service total (795) is 5 Channel Terminations. Therefore, the customer will be billed an amount equal to 5 Channel Terminations multiplied by the current Nonrecurring Channel Termination rate [$900]. For subsequent months, Customer A will continue to be billed an amount equal to the difference between 80% of the CL and the actual in-service number of Channel Terminations that are below 80% of the CL (multiplied) by the

Contrary to the assertions of Sprint and NoChokePoints,[179] the termination penalties in this tariff are likewise quite reasonable. When a customer walks away from its obligations under an agreement, it is only fair that the customer pay the amount they still owed under the agreement, plus a penalty that compensates the seller for the unexpected costs, such as the costs of unexpectedly having unused circuits. That is essentially what the termination penalty in the AT&T tariff relied on by Sprint and NoChokePoints does.[180] A customer that walks away is required to pay an amount equal to the discounted price of the tariffs for the remaining period of the term, *i.e.*, the amount they owed anyway, plus the difference between the discounted rate and the non-discounted rate to compensate AT&T for the costs of the unexpected termination.

4. Overage Provisions. For the reasons discussed above, it is economically justifiable for ILECs to offer significant discounts when customers make term, volume and revenue commitments, because those commitments significantly reduce the ILECs' risk and other costs. But these incentives exist only for those circuits (or revenues) that are subject to commitments. For example, where a customer commits to purchase 100 circuits for three years, that may justify a significant discount for those 100 circuits. If the customer actually purchases 200 circuits, however, the discounts are not necessarily justified for the additional 100 circuits, because the customer can cancel them at any time, such that discounts for those additional circuits are not economically justified. Nonetheless, AT&T recognizes that it is impossible for customers to perfectly predict the number of circuits they will need from AT&T. Accordingly, AT&T typically permits customers to obtain the same discounts for a certain number of circuits (or

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current nonrecurring Channel Termination rate, until 80% of the CL is met." AT&T Southwest Tariff No. 73, Section 7.2.22(E)(4)(b)(i).

[179] Sprint, at 41; NoChokePoints, at 28.

[180] AT&T Southwest Tariff No. 73, Section 7.2.22(E).

revenues) above their actual commitment as they receive for the circuits within their commitment; but there have to be limits, and at some point customers are required to pay full price for the extra circuits.

Sprint (at 40) criticizes these terms as "substantial 'overage penalties,'" citing Ameritech FCC Tariff No. 2, § 7.4.13. But there are no penalties here, and the terms, as noted, are eminently reasonable. In the AT&T tariff cited by Sprint, AT&T permits customers to receive discounts for up to 30 percent (for 3 year commitments) or 50 percent (for 5 year commitments) more circuits than the customer's commitment level. In other words, a customer that is committed to purchasing only 100 circuits for 5 years is still given the full discount for an additional 50 circuits, even though the customer may cancel those circuits at any time. If a customer exceeds those levels, it will still receive the discounts for the committed circuits, but will no longer be eligible for the discounts on the overage circuits. Sprint's unsupported assertion that these provisions serve no purpose other than to force customers to increase their commitments are thus completely without merit.[181]

5. Circuit Migrations. Sprint alleges that AT&T imposes excessive "charges to perform circuit migrations" and that these charges "increase the costs for customers to move circuits to lower-priced competitors."[182] But AT&T does not impose any charges when a customer seeks to migrate to a competitor. AT&T merely terminates service, and the customer can then take service from the competitor.[183]

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[181] *See also* Carlton-Shampine-Sider Reply Decl. ¶ 81.

[182] Sprint, at 41; *see also* NoChokePoints, at 30.

[183] As noted, if the customer subject to a term plan seeks to terminate prior to the expiration of that plan, the customer may be subject to an early termination penalty, which, as explained above, is quite reasonable and appropriate.

Sprint identifies no contrary tariff provisions. Indeed, the tariff provisions cited by Sprint have nothing to do with migrating to a competitor. Rather, the tariff provisions Sprint complains about, AT&T FCC Tariff No. 1, §§ 7.4.5(A) and (B) and Section 7.5.9, address a circuit "move," which is defined as "involv[ing] a change in the physical location of one of the following": (1) "The Point of Termination at the customer's premises" or (2) "The customer's premises." *Id.* In other words, these provisions govern the price that AT&T will charge a customer for shutting down a circuit in one location and setting up a circuit in a new location – not migrating a circuit to a competitor.

Sprint's assertion that these charges ordinary charges "bear little, if any, relation to the costs incurred by the incumbent LECs to execute" the move are baseless. These charges are based on cost studies that reflected truck rolls and technician time,[184] and often, at the request of the customer, are conducted during off hours, which adds overtime and other costs.[185] As one would expect, the price AT&T charges is much less when the circuit is moved to a different location in a building than when it is moved to a location in a different wire center. A move within a building is done at half the cost of an ordinary installation, whereas moves to a different

[184] These charges thus represent the average cost (in time and materials) of executing a move. The actual cost of executing any particular move may be more or less than the average, as is true of any business offering services at a fixed rate schedule. AT&T notes in this regard that automotive repair shops, for example, typically charge a fixed rate for labor for effecting particular types of repairs, such as replacing an alternator, based on the average time it takes to complete the repair, regardless of how much time it actually takes to replace the alternator for any particular vehicle.

[185] Dr. Mitchell, who is an economist, not a network engineer, asserts with no citation whatsoever, that these installations often involve "nothing more than a few keystrokes and rerouting the circuit from one port in a central office to another port a few feet away in the same office" is just wrong. Such moves typically involve the installation of new cross-connects and other time consuming activities.

wire center are treated as a new installation, and incur ordinary charges associated with such installations.[186]

6. Region-wide Discounts. Many AT&T customers offer services throughout the country. These customers do not care that AT&T has obtained downward pricing flexibility in some of those areas but not in others. Rather, these customers simply want to negotiate a deal with AT&T that allows them to make their desired purchases at the lowest overall price given the customer's overall spend with AT&T (or circuits purchased from AT&T). To accommodate these customers' desire for a discount mechanism that recognizes their overall purchases from AT&T, AT&T negotiates discounts with these customers in Phase I and Phase II areas that provide discounts based on the customer's overall spend (or circuit volumes).

Sprint (at 42), Level 3 (at 3), and Paetec (at 83) argue that the Commission should prohibit AT&T's customers from negotiating discounts based on their overall spend or circuit volumes, and that instead, customers should pay higher rates with discounts that reflect only their volumes in each local area.[187] According to these commenters, this prohibition is necessary because AT&T's low prices under these contracts preclude competitors from serving those customers in the areas where competitors have deployed competing facilities.

This argument fails for multiple reasons. First, these arguments are (again) refuted by the real-world facts showing that competitors can and do win customers in the areas where they have deployed competing networks, notwithstanding the challenged contract provisions. Second, these arguments are entirely unsupported. These commenters have identified no instance where a competitor was unable to effectively compete as a result of these contracts. Third, the lock-in theory fails because customers are not forced to purchase under region-wide discounts to obtain

[186] AT&T FCC Tariff No. 1, §§ 7.4.5(A) and (B).

[187] *See also* Mitchell Decl. ¶¶ 119-20.

the largest discounts – AT&T, for example, offers localized discount contracts as well. Fourth, the necessary implication of these proposals – that such contracts be prohibited and that the Commission force price cap LECs to charge *higher* prices in competitive areas to ensure that less efficient competitors are able to win customers – is directly contrary to the purpose of pricing flexibility, which allows ILECs to negotiate *lower* rates (so long as prices are not predatory).

Moreover, it is important to recognize that in challenging this type of arrangement, commenters are engaging in erroneous heads I win, tails you lose advocacy. For example, Paetec (at 5) complains about the "hoops" it has to jump through to obtain discounts in multiple regions. Yet, 78 pages later (Paetec at 83), Paetec proposes that the Commission should outlaw region-wide contracts.

7. Win Back Programs. Perhaps the most absurd allegations made by opponents of price cap LEC discounts relate to win back offers.[188] Under these programs, AT&T offered additional discounts to customers that agreed to move circuits from competitive alternatives to AT&T. In other words, AT&T competed for customers being served by a competitor by offering a lower price – classic price competition that should be encouraged.[189] No one asserts – let alone provides evidence – that the prices offered under these win-back programs were below AT&T's costs or the costs of any competitor. Competitors were free to lower their own prices in response to AT&T's offer, and likely some did. Indeed, although AT&T's win back programs succeeded in winning some circuits away from competitors, competitors clearly did not lose all or even a large portion of their circuits to these win-back programs. In all events, only one customer purchases services from AT&T under an active tariff with a win back provision.

[188] *See* Level 3 at 24.

[189] *See* Carlton-Shampine-Sider Reply Decl. ¶ 83.

8. UNE Conversions. Paetec and Level 3 argue that some AT&T discounts are conditioned on the customer converting existing UNEs to special access circuits or maintaining certain special access-to-UNE ratios and that such discount provisions are somehow anticompetitive.[190] But no customer would accept that deal unless it provided the customer with overall lower prices (or other significant benefits) that outweigh whatever benefits the customer attained by purchasing the circuits as UNEs. In other words, these offers provided customers with overall lower prices and a better deal than they had before, which is hardly a mark of a breakdown in the competitive marketplace.[191] In all events, AT&T no longer offers programs that contain access-to-UNE ratios.

V. ETHERNET SERVICES ARE HIGHLY COMPETITIVE AND NOT A SEPARATE PRODUCT MARKET.

tw telecom proposes that the Commission should consider examining and regulating the Ethernet services of ILECs. This proposal should be rejected out of hand. Ethernet services are subject to intense competition. Today, the majority of Ethernet ports are not supplied by ILECs. Indeed, the supply of Ethernet services is highly fragmented, with no single provider having more than 22 percent share and 8 separate providers having shares of 5 percent or more.[192] tw telecom makes this proposal despite the fact that in recent years, its market share increased by more than 55 percent, and the ILECs' collective market share fell by more than 20 percent.[193]

In this regard, tw telecom touts on the front page of its website that it has already overtaken one RBOC in terms of Ethernet market share and that tw telecom is now the number

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[190] Paetec, at 82; Level 3 at 25-26.

[191] *See also* Topper Decl. ¶ 67 (explaining that ILECs legitimately seek UNE conversions because "ILECs also benefit by reducing sales of UNEs; TELRIC-based UNE prices set by regulation are widely regarded as artificially low.").

[192] Vertical Systems Group, January 2010.

[193] *Id.*

three supplier of Ethernet services nationwide.[194] Indeed, tw telecom has consistently reported to its customers and investors that it expects this robust competition to "continue[] to intensify over time,"[195] that it would continue to "offer ever lower retail Ethernet prices,"[196] and that tw telecom is the "industry leader" with a "comprehensive portfolio of Ethernet Services."[197] As explained by the President of tw telecom's western division: "[o]ur growth significantly outpaces the market and our competitors" and "[u]nlike our competitors, we are achieving this growth without eroding other service revenues," which "gives us a significant advantage and allows us to pass along benefits to our commercial customers in the form of converged services, lower cost ownership, and increased functionality."[198]

For these reasons, the Commission has repeatedly rejected the claims raised here by tw telecom. The Commission has reasoned that "competitive carriers lead incumbent LECs in the deployment of Gigabit Ethernet switches,"[199] and that tw telecom's claims of a lack of competition for Ethernet services are "inconsistent with [tw telecom's] public statements that [tw telecom] can cost-effectively deliver Ethernet services to customers anywhere, even where it

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[194] *See* http://www.twtelecom.com/.

[195] *See Ex Parte* Letter from Thomas Jones (twt) to Marlene H. Dortch (FCC), FCC WC Docket No. 06-74, at 18 (Aug. 8, 2006).

[196] *Id.*; *see also id.* at 17 ("TWTC [Time Warner] operates in a competitive retail market"); Supplemental Comments of AT&T Inc., *Special Access Rates For Price Cap Local Exchange Carriers*, WC Docket No. 05-25, Casto Decl. (Aug. 8, 2007) (describing Ethernet offerings, both retail and wholesale, of numerous providers including cable companies).

[197] Time Warner Telecom, June 6, 2006 Press Release, at 1 ("*Overture Release*"), *available at* http://www.twttelecom.com/Documents/Announcements/News/2006/Overture.pdf.

[198] Cisco Customer Case Study, Provider Pioneers Flexible, Cost-Effective Ethernet Service (2008), *available at* www.cisco.com/en/US/solutions/collateral/ns341/ns524/ns562/ns577/case_study_c36-491995.pdf.

[199] Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Deployment of Wireline Servs. Offering Advanced Telecomms. Capability*, 18 FCC Rcd. 16978, ¶¶ 537-39 (2003); *see also* Order, *Qwest Petition for Waiver of Pricing Flexibility Rules for Advanced Communications Networks Services*, 22 FCC Rcd 7482, ¶ 6, n.23 (2007) (same).

may be uneconomical to build facilities connecting [tw telecom's] network to the customers' premises."[200]

tw telecom's claims are a naked attempt to hobble some of its largest competitors with onerous regulations and gain access to wholesale Ethernet services from ILECs at below competitive levels. tw telecom seeks this advantage in order to reduce the need to continue expanding its own network. This is ironic because tw telecom has elsewhere admitted that its historical success was achieved without the need to purchase any tariffed Ethernet service from AT&T.[201]

Even apart from the intense competition for Ethernet services, there is no legitimate basis for separately regulating wholesale finished Ethernet services. As explained by Sprint-Nextel (at 4, n.8), "[t]he technology used to provide the connection (*e.g.*, TDM or Ethernet) is not relevant to the analysis. Rather the product market definitions should focus solely on the economic cost of installing the connection and the revenue opportunities associated with a particular bandwidth (*e.g.*, DS1 or DS3)." Indeed, Ethernet is simply a *service* that can be provided over many different types of transport facilities, including copper, fiber, coaxial, and wireless facilities. Therefore, as long as competitors can deploy their own underlying transport facilities or obtain them at just and reasonable price levels, competitors will be able to (as they already do today) effectively compete in the provision of Ethernet services. The Commission has already found that high capacity circuits can be competitively supplied, and it is addressing in this proceeding

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[200] *Petition of ACS of Anchorage Forbearance Petition*, FCC 07-149, WC Docket No. 06-109, 2007 FCC LEXIS 6046, ¶ 102 (2007).

[201] *See Ex Parte* Letter from Thomas Jones (twt) to Marlene H. Dortch (FCC), WC Docket No. 06-74, at 6 (Nov. 20, 2006) (twt "has not purchased a single Ethernet circuit from AT&T under tariff").

issues related to the proper regulation of DSn facilities over which Ethernet (and other services) can be and are provided.

tw telecom (at 10) recognizes that its bid to have the Commission regulate finished Ethernet circuits must fail when such services can be provided using regulated DSn facilities, and therefore tw telecom argues Ethernet cannot be provided over DSn facilities. In fact, the record confirms that Ethernet can indeed easily be provided over TDM copper facilities (purchased from either a LEC or from a CLEC), with appropriate electronics placed at the endpoints of the circuit.[202] As XO recently explained to the Commission, "advances in copper technology have enabled the deployment of 'Ethernet Over Copper' ('EoC') technology, which supports data speeds up to 45 Mbps today and possibly greater than 100 Mbps in the future."[203] AT&T itself provisions Ethernet services in this way,[204] and tw telecom has elsewhere admitted that it does so as well quite successfully.[205] The Commission has therefore elsewhere "reject[ed] [tw telecom's] assertion that TDM-based loops cannot in many instances be used to provide packetized broadband services to enterprise customers," finding this assertion to be

[202] *See* Reply Declaration of Parley C. Casto, ¶¶ 7-12, attached to Joint Opposition of AT&T Inc. and BellSouth Corporation to Petitions to Deny and Reply to Comments, WC Docket No. 06-74, (June 20, 2006) ("Casto June 2006 Merger Decl."); Supplemental Declaration of Parley C. Casto, ¶¶ 6, 11-19, attached to Letter of Gary L. Phillips, AT&T, et al., to Marlene Dortch, at 5-11, WC Docket No. 06-74 (August 21, 2006) ("Casto Aug. 2006 Merger Decl."); Supplemental Reply Comments of AT&T Inc., *Special Access Rates For Price Cap Local Exchange Carriers*, WC Docket No. 05-25, Supplemental Declaration of Parley C. Casto, ¶¶ 11-14 (filed Aug. 15, 2007). *See also* Letter of Gary L. Phillips, AT&T, et al., to Marlene Dortch, at 5-11, WC Docket No. 06-74 (filed December 5, 2006).

[203] *Ex Parte* Letter from Regina M. Keeney (XO) to Marlene H. Dortch (FCC, Secretary), GN Docket Nos. 09-29, 09-47, 09-51; RM-11358, at 1 (Jan. 25, 2010).

[204] Casto June 2006 Merger Decl., ¶ 10.

[205] *See* Reply Declaration of Graham Taylor, ¶ 9, attached to Response of Time Warner Telecom, Inc. to AT&T Inc. and BellSouth Corporation Joint Opposition to Petitions to Deny and Reply to Comments, enclosed within August 8, 2006 ex parte Letter from Thomas Jones, counsel for Time Warner, to Marlene H. Dortch. *See also* Casto Aug. 2006 Merger Decl. ¶¶ ¶¶ 6, 11-19.

"inconsistent" with tw telecom's public statements and with the fact that tw telecom "has been able to compete in the provision of Ethernet services by relying on special access TDM loops (in addition to its own facilities)."[206] In addition to using special access TDM loops, tw telecom can also use below-cost UNE loops, which are widely available, to provide Ethernet services by adding the necessary electronics.

VI. GLOBAL CROSSING'S SUGGESTION THAT THE COMMISSION SHOULD ADOPT A SYSTEM OF FINAL ARBITRATION WOULD BE UNLAWFUL.

Finally, Global Crossing argues (at 10-16) that the Commission could side-step the nettlesome issue of analytical frameworks altogether if it would just establish a system of "final offer," or baseball-style arbitration for special access rates. Not only would such a scheme violate the specific requirements of Section 205 of the Act, adoption of this proposal would embroil the Commission and the industry in an enormous regulatory quagmire.

First, as Global Crossing itself concedes, its proposal would require the option of *de novo* review before the full Commission. That fact alone would negate any possible benefits from this scheme. The Global Crossing plan would invite special access customers across the country to invoke the new arbitration mechanism in the price cap LECs' many pricing flexibility MSAs. Although Global Crossing touts the cost and time-saving benefits of third-party baseball arbitration, it concedes that it would be unlawful for the Commission to force private parties to submit to binding arbitration,[207] and even apart from that concern, it would be unlawful for the Commission to delegate to private arbitrators its statutory mandate to oversee tariffed special

[206] *See, e.g.*, Memorandum Opinion and Order, *Petition of AT&T Inc. for Forbearance*, FCC 07-180, WC Docket No. 06-125, ¶ 26 (rel. Oct. 19, 2007).

[207] *See* Comments of Global Crossing North America, Inc., WC Docket No. 05-25, RM-10593, at 12 (Jan. 19, 2010) ("Global Crossing") (acknowledging that the Administrative Dispute Resolution Act would prohibit binding arbitration without *de novo* agency review).

access rates.[208] Accordingly, each individual arbitration decision would have to be subject to *de novo* review at the Commission, and there can be no doubt that the Commission would be quickly inundated with numerous individualized contract tariff disputes. Global Crossing's claim (at 12) that such appeals would be "infrequent and relatively easy to resolve" is naïve at best.

This scheme would be unlawful for another reason as well. Although Global Crossing proposes that an arbitrator would judge the two offers under a standard of "commercial reasonableness," the Commission itself could never lawfully apply such a standard in its own *de novo* review proceeding. To the contrary, *de novo* Commission review would necessarily take the form of a prescription under 47 U.S.C. § 205. However labeled, the arbitration proposals contemplate Commission-imposed rates implemented through tariff (as Section 203 would require for any new rate to become effective) and would operate to force a price cap LEC to file new rates that are different from those it has filed in its existing tariffs or that it offered to file in a new contract tariff.[209] Accordingly, the Commission could not prescribe a rate under this scheme unless it first finds that the rate that the carrier has proposed and filed is unjust and

[208] *See, e.g., U.S. Telecom Ass'n* v. *FCC*, 359 F.3d 554, 565 (D.C. Cir. 2004) ("[I]f anything, the case law strongly suggests that subdelegations to outside parties are assumed to be improper absent an affirmative showing of congressional authorization").

[209] *See, e.g., MCI Telecomms. Corp.* v. *FCC*, 627 F.2d 322, 337 (D.C. Cir. 1980) (it "is the actual impact of the FCC's actions, rather than the language it uses, which determines whether or not the FCC has 'prescribed' tariffs or other conditions under the statute").

unreasonable.[210] As the D.C. Circuit has cautioned, "the[se] mandates of the Act are not open to change by the Commission."[211]

Accordingly, in its *de novo* review, the Commission could not simply ask whether the arbitrator's chosen rate is the more "commercially reasonable" of the two offers, nor could it uphold a lower rate chosen by an arbitrator merely on the ground that this rate is "just and reasonable." Rather, it could not require the lower rate unless it first determined that the rates that the price cap LEC has filed and proposed are themselves unjust and unreasonable and outside the zone of just and reasonable rates. Indeed, because there is a broad range of rates that are just and reasonable, the mere fact that an arbitrator (or the Commission) believes that a CLEC-proposed rate is more "commercially reasonable" could not remotely establish that AT&T's existing rate or proposed new contract tariff rate is unjust and unreasonable.[212]

Finally, Global Crossing's reliance on merger conditions imposing an arbitration requirement in the *Hughes*, *Adelphia*, and *News Corp.* cases is misplaced.[213] In those proceedings, the Commission was filling a perceived statutory *gap* with a voluntarily offered merger condition. The special access rates at issue here, by contrast, are governed by a specific

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[210] 47 U.S.C. § 205; *see AT&T*, 487 F.2d at 872-80 (a "full opportunity for hearing" and express Commission findings that the carrier-initiated rate is unjust and unreasonable and the prescribed rate is just and reasonable "are essential to any exercise by the Commission of its authority" to prescribe rates).

[211] *Southwestern Bell Corp.*, 43 F.3d at 1520 ("Commission is not free to circumvent or ignore th[e] balance [created by Congress]. Nor may the Commission rewrite this statutory scheme on the basis of its own conception of the equities of a particular situation").

[212] *Fed. Power Comm'n* v. *Conway Corp.*, 426 U.S. 271, 278 (1976) ("there is no single cost-recovering rate, but a zone of reasonableness: 'Statutory reasonableness is an abstract quality represented by an area, not a pinpoint'").

[213] Memorandum Opinion and Order, *Gen. Motors Corp.*, 19 FCC Rcd. 473 (2004) ("*Hughes Merger Order*"); Memorandum Opinion and Order, *Adelphia Comms. Corp.*, 21 FCC Rcd. 8203 (2006) ("*Adelphia Merger Order*"); Memorandum Opinion and Order, *News Corp.*, 23 FCC Rcd. 3265, ¶ 88 (2008) ("*News Corp Order*").

statutory procedural provision, Section 205, which the Commission is not at liberty to ignore.[214] Moreover, the existing regime provides extensive safeguards to access purchasers,[215] including complaints under Section 208 of the Act.[216] It is therefore difficult to conceive how the proposed arbitration regime, which would only add a layer to the required Commission consideration, could improve matters.

[214] *Southwestern Bell Corp.*, 43 F.3d at 1520 (D.C. Cir. 1995).

[215] *See WorldCom, Inc.*, 238 F.3d 449 (existing tariff and pricing flexibility regime sufficient to protect access ratepayers).

[216] 47 U.S.C. § 208(b)(1) ("the Commission shall, with respect to any investigation under this section of the lawfulness of a charge, classification, regulation, or practice, issue an order concluding such investigation within 5 months after the date on which the complaint is filed").

CONCLUSION

The Commission should adopt a framework for assessing the special access marketplace as discussed herein and in AT&T's January 19, 2010 Comments in this proceeding.

Respectfully submitted,

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APPENDIX A

Several proponents of special access re-regulation rely on various benchmarks and comparisons that have repeatedly been refuted in this proceeding. Without repeating everything in the record relating to these issues, this Appendix details some of the more glaring problems with these benchmarks.

A. Undiscounted Rack Rates.

Unable to establish that the prices customers actually pay for ILEC DSn-level special access services have increased – the record indisputably establishes that those prices have consistently and substantially declined since 2001 – certain commenters argue that the Commission should instead make policy decisions based on the price cap LECs' non-discounted rack rates.[1] As the Commission is well-aware, price cap LECs are *required* to file tariffs with list prices (or "rack" rates). To negotiate individualized deals in this quickly evolving competitive marketplace, price cap LECs provide term and volume discounts, and, in areas where price cap LECs have attained pricing flexibility, customers routinely negotiate additional discounts. Consequently, anyone analyzing special access rack rates may as well be analyzing the price of tea in China – neither provides useful information about competition in the special access marketplace or relevant pricing trends in areas subject to pricing flexibility.

B. Price-Flex to Price Cap Comparisons.

Some critics, relying on the GAO Report and NRRI report, assert that prices have on average decreased more for some Phase I areas than in some Phase II areas, and that this

[1] *See, e.g.*, Comments of Comptel, WC Docket No. 05-25, RM-10593, at 16 (Jan. 19, 2010) ("Comptel"); Global Crossing at 8; NoChokePoints, at 18-21; Mitchell Decl. ¶ 103.

disparity indicates a lack of competition in Phase II areas.[2] This argument fails for several reasons.

First, the argument is based on the false premise that Phase I areas are non-competitive. The comments demonstrate, however, that many of the most competitive MSAs, including New York and Chicago, remain under price caps, due to the very conservative nature of the current pricing flexibility triggers, which fail adequately to account for intermodal and much intramodal competition.[3] Consequently, the fact that price declines may differ between particular Phase I and Phase II areas says nothing about whether the prices in either area are constrained by competition.

The argument is also based on the false premise that the price caps have been set *above* competitive levels. As the Commission noted in its response to the GAO Report, it has "explicitly recognized that Phase II pricing relief could lead to price increases for customers in some areas," which in and of itself would not be any cause for concern.[4] That is because there is no basis for believing that the winding and often arbitrary path that price caps have taken over the last twenty years has resulted in rates in price cap areas that are higher or more "reliable" than those determined in the free market. Price cap indices were initially set based on rates that resulted from years of rate-of-return regulation, which was acknowledged to be flawed,[5] and have been subjected to numerous regulatory adjustments over the years, some of the most important of which (such as the X-Factors applied between 1997 and 2000) were judicially

[2] *See* NoChokePoints, at 19, Sprint, at 29-30.

[3] *See, e.g.*, AT&T at 56-57; Verizon at 20; Qwest at 30-31.

[4] *See* Letter from FCC (Anthony Dale, Managing Director) to GAO (Mark Goldstein, Director, Physical Infrastructure Issues), at 2 (Nov. 13, 2006) *reprinted in* GAO Report, App. III ("FCC GAO Response Letter") (citing *Pricing Flexibility Order*, 14 FCC Rcd 14221, ¶ 155).

[5] *See, e.g.*, Second Report and Order, *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, ¶¶ 23, 26-29, 34 (1990) ("*Price Cap Order*").

determined to be arbitrary (although never corrected).[6] In the *CALLS Order*, price cap rates were arbitrarily reduced further by various negotiated factors,[7] which all parties understood would not be applied in Phase II MSAs. For all of these reasons, it is increasingly frivolous after twenty years to assume that the rates that have emerged from this process are more accurate reflections of a competitive rate than the rates actually determined by the marketplace in Phase II areas.[8]

Finally, neither the GAO Report nor the NRRI Report – the data that the critics rely upon – establish that prices have fallen by more in Phase I areas than in Phase II areas. The GAO Report expressly states that its results (1) do not account for "every discount that was based on Phase II contracts;"[9] (2) do not reliably allocate discounts between Phase I and Phase II areas because the GAO "d[id] not know the details of how the circuits purchased under these contracts are configured;"[10] and (3) reflect "imperfect weight[ings]" in estimating Phase I and Phase II prices.[11] In short, the GAO lacked "[t]he data required to analyze the various factors that contribute to an overall contractual price."[12] The NRRI results were based on undocumented

[6] *USTA*, 188 F.3d at 525-26; AT&T 2007 Comments at 40-41.

[7] Sixth Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service*, 15 FCC Rcd 12962, ¶ 40 (2000) (the negotiated X-Factor is not a true "productivity estimate" but merely a "method to reduce rates to certain levels").

[8] Similarly, the 2004 Uri and Zimmerman study, on which commenters rely (*e.g.*, NoChokePoints, at 20) includes only *term* discounts in its calculation of RBOC "Optional Payment Plan Rates"; it ignores the RBOCs' volume and contract discount offers, which account for virtually all pricing flexibility purchases. To omit these discounts from the price story introduces severe inaccuracies.

[9] GAO Report at 57, n.2.

[10] *Id.* at 56.

[11] *Id.* at 59.

[12] *Id.* at 56.

"buyer data" from a small subset of buyers that the NRRI had "limited ability to . . . verify."[13] Further, contrary to the claims of the critics, virtually all of the NRRI comparisons lacked any statistical significance for the two years tested (2006 and 2007), except that NRRI found statistically significant results showing that DS1 rack rates were *lower* in Phase II areas than in Phase I areas.[14]

C. Special Access to UNE Comparisons.

Some critics continue to push the absurd notion that special access rates should be priced similarly to unbundled network elements ("UNEs"), which are based on the TELRIC pricing methodology.[15] The Commission has repeatedly held that it would be inappropriate to apply the TELRIC methodology to special access.[16] Even in the early days of the 1996 Act when the

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[13] NRRI Report at 38.

[14] *Id.* at 65.

[15] *See* NoChokePoints at 22-23; Paetec, at 67-72, Sprint, at 26-27; Mitchell Decl. ¶ 102; tw telecom, at 22. Comptel tries to stack the deck even further by claiming (at 16) that the Commission should compare TELRIC rates to the ILECs' *rack* rates. For the reasons stated above, rack rates are irrelevant to assessing that issue because they do not reflect the prices actually paid by customers.

[16] *Access Charge Reform Order*, ¶ 295*;* Supplemental Order Clarification, *Implementation of the Local Competition Provisions of the Telecomms. Act of 1996*, 15 FCC Rcd. 9587 (2000), *aff'd, CompTel* v. *FCC*, 309 F.3d 8 (D.C. Cir. 2002); Report and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 18 FCC Rcd. 16978, ¶¶ 591-600 (2003) ("*Triennial Review Remand Order*"); *U.S. Telecom Ass'n*, 359 F.3d at 590-92; Order on Remand, *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, FCC 04-290, WC Docket No. 04-313, CC Docket No. 01-338, ¶ 51 (rel. Feb. 4, 2005) (rejecting arguments that special access and UNEs should be priced the same; "Congress's enactment of section 251(c)(3), and the associated cost-based pricing standard in section 252(d)(1), at a time when special access services were already available to carriers in the local exchange market indicates that UNEs were intended as an *alternative* to these services, available at alternative pricing . . . . Special access prices are regulated pursuant to the Communications Act's 'just and reasonable' standard, which predates *and bears no necessary relation* to this [UNE] cost-based standard") (latter emphasis added).

Commission was more sanguine about the objective merits of TELRIC, the Commission consistently rejected using TELRIC to price special access, in part because it recognized that TELRIC had many aggressively pro-CLEC quirks, assumptions, and features that were designed to quickly jump-start competition for local service. The Commission has since identified major flaws in TELRIC even for the purposes for which it was intended. In particular, the Commission has recognized the criticisms that TELRIC prices are not in any real sense "cost-based," but are based on "purely hypothetical" models of networks constructed using "unrealistic" and internally inconsistent assumptions about the market.[17] The Commission has further explained that the TELRIC rules are "extremely complicated," "excessively hypothetical," and "very general," leading to highly "variable results" in UNE prices that do not in fact "reflect genuine cost differences."[18] Thus, the mere fact that marketplace special access prices might be higher than certain TELRIC-based UNE rates set by state regulators says nothing about the reasonableness of those marketplace rates.[19]

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[17] *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, Notice of Proposed Rulemaking, 18 FCC Rcd. 20265, ¶¶ 4-5 (2003).

[18] *Id.* ¶ 5 (acknowledging that TELRIC has "been the subject of extensive criticism"). The very low UNE rate levels are also an artificial by-product of the section 271 proceedings, which created a one-way ratchet. The Commission sought only to assure that rates were not too high by adopting benchmarks to which BOCs had to lower their UNE rates. In these situations, there was "no comparable process" to "correct[] rates when an error in applying the TELRIC rules results in rates that are inappropriately low." *Id.* ¶¶ 27-28.

[19] *See also* Carlton-Shampine-Sider Reply Decl. ¶¶ 33-36. In addition, although the Commission has recognized that the availability of UNEs can exert downward pressure on special access prices, *e.g.*, UNE Remand Order, 20 FCC Rcd. 2533, ¶ 65, it has found, with the D.C. Circuit's approval, that permitting carriers to purchase the functional equivalent of special access services at TELRIC indiscriminately would harm the development of competition by, among other things, "undercut[ting] the market position of many facilities-based competitive access providers," a "mature source of competition in telecommunications markets." *Supplemental Order Clarification*, ¶ 18.

It is also ironic that certain commenters call for TELRIC-based pricing of special access (*see, e.g.*, Paetec at 69), when only pages earlier in their comments they argue that the Commission cannot consider TELRIC-priced UNEs as a substitute for special access because at those prices they "lack service quality guarantees."[20]

D. Special Access to DSL, FiOS, Uverse and Cable Comparisons.

Sprint's claims that the reasonableness of DS1 prices can be assessed by comparison to prices of consumer broadband Internet services, such as DSL, FiOS U-Verse, and cable modem services are baseless.[21] Sprint has previously conceded that "there are differences between special access services and consumer broadband services that may justify some price differential,"[22] and that is a gross understatement. Some of the most important differences include: (1) residential broadband offerings are provided on a "best efforts" basis, whereas business DS1 services are dedicated circuits; (2) DS1 services typically include, among other things, symmetrical, fixed upstream and downstream speeds, static IP addresses,[23] dedicated sales and support teams, and various other features that entry-level residential broadband services lack; and (3) the entire cost of a DS1 line generally is recovered from the price of the DS1 service, whereas the costs of the lines over which DSL, FiOS, U-Verse services, and cable modem services are only partially recovered through the residential broadband charge, with the

[20] *Id.* at 56-57.

[21] Sprint at 27-28; *see also* NoChokePoints at 23-24 (relying on Sprint comparison).

[22] Sprint at 28, n.91 ("there are differences between special access services and other broadband services that may justify some price differential (for example, DSL, cable modem and FiOS offer only 'best efforts' level of services"); *see also* NoChokePoints at 24 ("the services are not identical, and these differences may justify some difference in price").

[23] An Internet access service that provides a "static" IP address assigns the customer's computer equipment the same IP address each time it connects to the Internet. This enables the customer to "host" a web site or engage in other activities that require other computers on the Internet to be able to reliably find that customer's computer equipment.

remainder recovered through revenues from separately purchased voice services, vertical features (*e.g.*, caller ID, call forwarding, and call blocking), and, in many instances, video services.[24] The specific comparisons provided by Sprint are particularly misleading and invalid because they compare DSL, FiOS, U-Verse services, and cable modem services, which are typically less than a mile and rarely more than three miles in length, to *10-mile* DS1 lines[25] – a fact that, by itself, may explain most of the rate difference Sprint claims.

In this regard, many of the commenters that rely on such comparisons are being quite disingenuous. On the one hand, they both argue that DSL and cable modem services confirm that special access prices are too high, while in the same comments arguing that cable modem and DSL services are so different from special access services that they cannot be placed in the same product market. They cannot have it both ways: either the prices are incomparable, or the services are in the same product market as DSn level special access services.

But even if any relevant information could be obtained by comparing DS1 prices to other broadband services, DS1 special access prices are *not* necessarily higher. For example, the list price for AT&T DSL service that most resembles a DS1 service is AT&T's Business Class DSL service, which provides a dedicated line, static IP addresses and symmetrical 1.5 Mbps upload and download speeds for $399.95 per month[26] – which is near to or even higher than many of the AT&T DS1 rates relied on by these commenters.[27]

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[24] *See also* Carlton-Shampine-Sider Reply Decl. ¶ 24.

[25] *See also id*.

[26] *See* AT&T DSL Internet Service, https://businessesales.att.com/products_services/dslinternet_available.jhtml (last visited Oct. 24, 2007). *See also* Verizon 2007 Reply at 9-10, n.12 ("Verizon's 'Premium DSL' service, with symmetrical 1.5 Mbps speed and static IP address, is $222.00 per month").

[27] *See*, *e.g.*, Paetec, at 8.

E. Comparing US and Foreign DSn Prices.

Sprint asserts U.S. special access prices are excessive based on comparisons submitted by BT Americas in 2005 and 2007. AT&T has demonstrated that those comparisons are fundamentally flawed apples-to-oranges comparisons,[28] and BT, in 2009 submitted new comparisons that Sprint does not rely upon here.[29] But as AT&T has shown, even BT's most recent price comparison is fundamentally flawed, and an accurate comparison confirms that AT&T's prices are actually lower than BT's prices.[30] As AT&T showed, BT's comparison contained a number of flaws. For example, BT appears to have compared actual prices paid by customers in Britain to non-discounted rack rates in the U.S., thus significantly overstating actual U.S. prices.[31] BT also appears to have compared U.S. DS3 circuits with *two* channel terminations to British circuits with only *one* channel termination, thus further overstating U.S. prices.[32] BT further failed to properly convert British currency to U.S. currency – it used the OECD's 2009 Purchasing Power Parities rate rather than actual currency exchange rates, which discounts BT's rates by an additional 14 percent below what its services would cost if purchased using U.S. dollars exchanged commercially at a bank.[33] AT&T showed that a more accurate

[28] AT&T 2007 Reply at 34-35; *Ex Parte* Letter from Gary L. Phillips (AT&T) to Marlene H. Dortch (FCC Secretary), WC Docket No. 05-25, at 5 (Feb. 21, 2008).

[29] *Ex Parte* Letter from Shepa Chacko (BT) to Marlene H. Dortch (FCC), WC Docket No. 05-25 (Sept. 18, 2009).

[30] *Ex Parte* Letter from Robert W. Quinn (AT&T) to Marlene H. Dortch (FCC, Secretary), WC Docket No. 05-25, at 8-10 (Nov. 4, 2009). *See also* Carlton-Shampine-Sider Reply Decl. ¶ 30.

[31] *Id.*

[32] *Id.*

[33] *Id.*

comparison using prices actually paid confirms that U.S. rates are actually substantially lower than those in Britain.[34]

F. Comparing ILEC and CLEC DSn prices.

Paetec asserts that that the Commission can glean useful information about ILEC special access rates by comparing them to CLEC special access rates. But even if Paetec could establish the existence of such price differentials (which, as explained below, it has not), that would hardly suggest any market failure, much less the clear and substantial market failure necessary to justify the onerous, investment chilling regulation that Paetec advocates. Even significant rate differences among established and new competitors are commonplace in competitive markets.[35] Not surprisingly, many CLECs enter a market by first providing service in the highest-density, highest-demand, highest-bandwidth, and cheapest-to-serve segments of the market, which yields per-line costs (and prices) below that of the ILEC, which is required to serve *all* customers at *all* bandwidths *throughout* MSAs.[36] In other words, lower CLEC prices in many cases reflect the freedom these new entrants have to choose their service areas, not ILEC market power. Moreover, ILECs often pursue a strategy of offering a product with superior quality and service at a premium price. This type of "gold-standard" service is also common in competitive marketplaces and not evidence of market power.

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[34] *Id.*

[35] *See, e.g., Triennial Review Remand Order*, ¶ 85, n.278 (acknowledging that regulation should "account for any countervailing [competitor] advantages, such as being able to sell other services, avoid costs, achieve qualitative advantages unavailable to the incumbent LEC, cherry-pick profitable customers or markets, and use more efficient equipment and network architectures").

[36] *See Tex. Office of Pub. Util. Counsel* v. *FCC*, 265 F.3d 313, 318 (5th Cir. 2001) ("In a competitive market, a carrier that subsidizes rural or poor customers by charging below-cost rates while billing above-cost rates to urban customers will be undercut by a competitor").

In all events, Paetec has not even established that any CLEC charges a lower price than any price cap ILEC for the same service. Paetec's assertion of such pricing disparities is based solely on comparisons made by others that have been shown to be fundamentally flawed and thus irrelevant here. For example, Paetec refers to a comparison conducted by tw telecom in 2008.[37] But AT&T and Qwest have demonstrated that tw telecom compared apples to oranges, used incorrect ILEC prices, relied on CLEC offers and pricing guidelines rather than the actual prices paid by their customers, and that tw telecom's comparisons were so completely undocumented that it was impossible to determine even which CLECs were used in the comparison or where the CLECs supposedly offered the prices used in the comparison.[38] Indeed, tw telecom subsequently abandoned many of its comparisons, and candidly admitted that the pricing information it had used "d[id] not enable TWTC to conduct a reliable, apples-to-apples comparison with incumbent LEC special access prices" for the price comparisons it did not withdraw.[39] The 2005 price comparisons of Comptel and WilTel were likewise completely undocumented and failed to establish that any CLEC offered a lower price than any ILEC for the same service. Indeed, it is telling that none of the parties that initially submitted the comparisons now relied on by Paetec attempt to defend them or rely on them in their comments responding to the *Notice.*

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[37] Paetec at 70, n.241.

[38] *See Ex Parte* Letter from Gary Phillips (AT&T) to Marlene H. Dortch (FCC), *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25 (March 3, 2008); *Ex Parte* Letter from Gary Phillips (AT&T) to Marlene H. Dortch (Secretary), *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, at 6-7 (Feb. 6, 2009); *Ex Parte* Letter from Gary Phillips (AT&T) to Marlene H. Dortch (FCC), *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, at 6-7 (Nov. 4, 2009); *Ex Parte* Letter from Craig J. Brown (Qwest) to Marlene H. Dortch (FCC), *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25 (Oct. 2, 2007).

[39] *Ex Parte* Letter from Thomas Jones (tw telecom) to Marlene H. Dortch (FCC), *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, at 3 (July 9, 2009).

G. Comparing ILEC and NECA DSn Prices.

Paetec compares price cap ILECs' tariffed Phase II special access one-year term rack rates to certain of NECA's tariffed one-year term rates. But that is a meaningless apples-to-oranges comparison of ILEC rack rates that does not reflect contract tariff, overlay and other discounts that customers routinely demand to the NECA prices that customers do actually pay.[40] The comparison is also jerry-rigged. It compares NECA zone 1 rates to ILEC zone 1 rates. But less than 1 percent of NECA carriers (8 carriers out of more than 1100 NECA carriers) actually charge zone 1 rates, and those carriers can have an extremely low cost of providing special access service – indeed, by definition, these carriers have costs that are at least 40 percent lower than the average NECA carrier.[41] Although there is no way here to conduct an accurate apples-to-apples comparison of ILEC and NECA rates (because any such analysis would have to account for relevant cost and other differences), a more reasonable comparison would be that of an average NECA carrier to that of the highest cost ILEC Zone.[42] The average NECA carrier is in NECA Zone 7. The NECA Zone 7 price is $497 (more than double the Zone 1-only figure of $218.33 that Paetec uses), which much higher than the non-discounted AT&T prices in three of the four AT&T areas presented in Paetec's comparison.

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[40] *See also* Carlton-Shampine-Sider Reply Decl. ¶¶ 27-29.

[41] NECA Zone 1 carriers have far fewer customers than are in ILEC Zone one areas. Moreover, the NECA Zone 1 customers are typically highly concentrated and are often located very near the NECA carriers' central offices, which means that these customers can be served at very low cost compared to an ILEC Zone one customers which can be spread throughout a metropolitan area.

[42] *See also* Carlton-Shampine-Sider Reply Decl. ¶¶ 27-29.